Nos. 84-871, 84-889, 84-1054, and 84-1069

In the Supreme Court of the United States

OCTOBER TERM, 1984

Louisiana Public Service Commission, Appellant
v.
Federal Communications Commission and
United States of America

California and Public Utilities Commission
of California, et al., Petitioners
v.
Federal Communications Commission and
United States of America

Public Utilities Commission of Ohio,
et al., Petitioners
v.
Federal Communications Commission and
United States of America

Florida Public Service Commission, Petitioner
v.
Federal Communications Commission and
United States of America

On Appeal And On Petitions For A Writ Of
Certiorari To The United States Court Of Appeals
For The Fourth Circuit

BRIEF OF APPELLANT, THE LOUISIANA PUBLIC SERVICE COMMISSION, AND PETITIONERS, THE PUBLIC UTILITIES COMMISSION OF OHIO, THE OHIO OFFICE OF CONSUMERS' COUNSEL, AND THE FLORIDA PUBLIC SERVICE COMMISSION

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QUESTION PRESENTED

May the Federal Communications Commission order State regulatory agencies to increase intrastate rates to further a Federal policy allowing telephone companies faster capital recovery, although the Communications Act reserves jurisdiction over intrastate rates to the States?[1]

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[1] The Virginia State Corporation Commission was the petitioner in the proceeding before the court of appeals. The Federal Communications Commission and United States of America were respondents. The Louisiana Public Service Commission, Public Utilities Commission of Ohio, Office of Consumers' Counsel for the State of Ohio, and Florida Public Service Commission were intervenors supporting the petitioners. The following parties also supported the petitioner:

State of Michigan and Michigan Public Service Commission;
Department of Public Utility Control of the State of Connecticut;
People of the State of California and the Public Utilities Commission of the State of California;
National Association of Regulatory Utility Commissioners;
Public Service Commission of the District of Columbia;
Arkansas Public Service Commission;
Kansas State Corporation Commission;
Public Service Commission of Wyoming;
Washington Utilities and Transportation Commission;
Department of Public Service of the State of Minnesota;
Arizona Corporation Commission;
Citizens of the State of Florida;
National Association of State Utility Consumer Advocates;
Consumer Advocate of South Carolina;
Iowa State Commerce Commission;
Public Service Commission of Wisconsin;
Public Service Commission of West Virginia;
New York State Department of Public Service; and
Board of Public Utilities of New Jersey.

The intervenors supporting the respondents included:

North American Telephone Association;
American Telephone and Telegraph Company;
Southern Pacific Communications Company;
GTE Service Corporation;
Continental Telecom, Inc.;
United Telephone System, Inc.;
Cincinnati Bell, Inc.;
The Bell Telephone Company of Pennsylvania;
The Chesapeake and Potomac Telephone Company;
The Chesapeake and Potomac Telephone Company of Maryland;
The Chesapeake and Potomac Telephone Company of Virginia;
The Chesapeake and Potomac Telephone Company of West Virginia;
The Diamond State Telephone Company;
Illinois Bell Telephone Company;
Indiana Bell Telephone Company, Inc.;
Michigan Bell Telephone Company;
The Mountain States Telephone and Telegraph Company;
New England Telephone and Telegraph Company;
New Jersey Bell Telephone Company;
New York Telephone Company;
Northwestern Bell Telephone Company;
The Ohio Bell Telephone Company;
Pacific Northwest Bell Telephone Company;
The Pacific Telephone and Telegraph Company;
Bell Telephone Company of Nevada;
South Central Bell Telephone Company;
Southern Bell Telephone and Telegraph Company;
Southwestern Bell Telephone Company; and
Wisconsin Telephone Company.

STATEMENTS OF SUPPORT

The following parties in Docket No. 84-889 have authorized the parties sponsoring this brief to state that the listed parties support the positions advanced here as well as those contained in their own brief: National Association of Regulatory Utility Commissioners, Arkansas Public Service Commission, California and California Public Utilities Commission, Department of Public Utility Control of the State of Connecticut, Public Service Commission of the District of Colunbia, Public Counsel of the State of Florida, Iowa State Commerce Commission, Kansas State Corporation Commission, State of Michigan and Michigan Public Service Commission, Department of Public Service of the State of Minnesota, New York State Department of Public Service, South Carolina Consumer Advocate, Washington Utilities and Transportation Commission, Wisconsin Public Service Commission.

In addition, the parties sponsoring this brief support the positions advanced by the parties in Docket No. 84-889.

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The opinion of the court of appeals is reported as *Virginia State Corp. Com'n v. F.C.C.*, 737 F.2d 388 (4th Cir. 1984) (Jurisdictional Statement Appendix ("J. S. App.") at A-1 *et seq.*) This opinion affirmed a ruling of the Federal Communications Commission, which is reported as *Amend. of Part 31*, 92 F.C.C.2d 864 (1983) (J.S. App. at A-24 *et seq.*) The ruling overruled a previous decision of the Commission, reported as *Amend. of Part 31*, 89 F.C.C.2d 1094 (1982) (J.S. App. at A-61 *et seq.*)

JURISDICTION

The Jurisdictional Statement and Petitions for Writs of Certiorari review the relevant dates.[2] The appellate jurisdiction of the Court is invoked in No. 84-871 pursuant to 28 U.S.C. §1254(2); the certiorari jurisdiction is invoked in Nos. 84-889, 84-1054 and 84-1069 pursuant to 28 U.S.C. §1254(1).

The Court postponed the question of jurisdiction in No. 84-871 to the hearing of the case on the merits. That issue is addressed in Section II.

STATUTORY PROVISIONS

The following federal statutes, reprinted commencing at J.S. App. A-131, are involved in this case:

47 U.S.C. §151
47 U.S.C. §152
47 U.S.C. §153(e)
47 U.S.C. §220

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2 Jur. St., No. 84-871, at 3; Pet., No. 84-1054, at 1; Pet., No. 84-1069, at 2. *See also* J. S. App. at A-90 - A-93.

47 U.S.C. §221(b)
47 U.S.C. §221(c)
47 U.S.C. §410

Certain Louisiana State ratemaking orders were invalidated by the *Preemption Decision* of the Federal Communications Commission, as enforced in a Federal court injunction proceeding, and are set forth beginning at J.S. App. A-94.

STATEMENT OF THE CASE

Preliminary statement.

The issue is whether the Federal Communications Commission ("FCC") may require State regulatory commissions to increase intrastate telephone rates, despite express statutory provisions reserving jurisdiction over these rates to the States. The FCC preempted State ratemaking practices that were inconsistent with two of its own accounting orders[3] and mandated the adoption of the Federal procedures in setting intrastate rates.[4] The United States Court of Appeals for the Fourth Circuit affirmed the *Preemption Decision* by a 2-1 majority.[5]

The *Preemption Decision* discarded nearly 50 years

[3]*Amend. of Part* 31, 83 F.C.C.2d 267 (1980); *Amend. of Part 31,* 85 F.C.C.2d 818 (1981).

[4]*Amend. of Part 31,* 92 F.C.C.2d 864 (1983) (hereinafter cited as "*Preemption Decision*"), J. S. App. at A-24.

[5]*Virginia State Corp. Com'n v. F.C.C.,* 737 F.2d 388, 396 (4th Cir. 1984), J.S. App. at A-1, A-17.

of history, in which Federal and State regulatory responsibilities have been divided using a separations process pursuant to the Communications Act. It ordered that rates be increased for plant assigned to State regulation. To justify its action, the FCC characterized a reporting provision in the Communications Act as an authorization for intrastate ratemaking. To assist the Court in understanding the magnitude of the FCC action, this brief will review the regulatory context in which the *Preemption Decision* was issued.

1. Interstate-intrastate separations.

Since prior to passage of the Communications Act,[6] the interstate and intrastate plant and expenses of telephone carriers have been, and continue to be, divided for ratemaking purposes. Purely intrastate plant and expenses are assigned directly to the relevant intrastate jurisdiction.[7] Purely interstate plant and expenses are assigned to the interstate jurisdiction.[8] Jointly used plant and expenses — the investment and costs incurred to serve both interstate and intrastate purposes — are divided using separations factors. These factors are developed by Federal-State Joint Boards, composed of FCC members and representatives of State agencies.[9] The FCC sets interstate toll rates and interstate "access" charges to cover the expenses and provide a return on the investment

[6]*See Smith v. Illinois Bell Telephone Co.,* 282 U.S. 133 (1930).

[7]*See, e.g., 47 C.F.R.* §§67.124(b),(c),(d), 67.125(c), (d), 67.311(b) (1984).

[8]*See* regulations cited in n.7 *supra.*

[9]*See* 47 U.S.C. §410(c).

assigned to the interstate jurisdiction. The State agencies set intrastate rates and charges to cover intrastate expenses and provide a return to intrastate investment.

The separations process emanates from *Smith v. Illinois Bell Tel. Co.,*[10] where this Court mandated the separation of the intrastate and interstate plant and expenses of a telephone company in testing the fairness of an intrastate rate order. The Court ruled that "[t]he proper regulation of rates can be had only by maintaining the limits of state and federal jurisdiction . . . ."[11] It required a reasonable apportionment of the property of the company based on use.[12]

In the Communications Act of 1934, Congress recognized the need to separate the property of carriers for ratemaking. It provided that the FCC could classify the property used for interstate communications.[13] Subsequently, the FCC and State regulators cooperated to develop simple and equitable separations procedures.[14] In 1971, Congress passed the Federal-State Communications Joint Board Act, 47 U.S.C. §410(c), which memorializes procedures previously developed for making jurisdictional

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[10]282 U.S 133 (1930).

[11]*Id.* at 149.

[12]*Id.* at 151.

[13]47 U.S.C. §221(c), J.S. App. at A-137.

[14]*See* the Senate Report on the 1971 Federal-State Communications Joint Board Act, enacted as 47 U.S.C. §410(c). S.Rep. No. 92-632, 92d Cong., 1st Sess., *reprinted in* 1971 U.S. Code Cong. & Ad. News 1511, 1512.

separations. Currently about 25 per cent of telephone plant is allocated to the interstate jurisdiction, and about 75 per cent remains in the intrastate jurisdictions.[15]

2. FCC Uniform System of Accounts.

Section 220 of the Communications Act authorizes the FCC to prescribe the form of accounts for certain telephone carriers and requires these carriers to maintain their records as prescribed by the FCC.[16] This section also gives authority to the FCC to prescribe depreciation practices.[17] These provisions permit the FCC to prescribe a uniform basis for *reporting* the financial affairs of carriers, for the benefit of investors, creditors, regulators, management and others.[18] The FCC uniform system of accounts has never been viewed as binding for ratemaking at either the Federal or State level.[19] State agencies often rely on the FCC uniform system, but carriers usually maintain separate intrastate records to accommodate intrastate ratemaking practices.

The purpose of uniform accounting is to require carriers to report their affairs on a comparable basis.[20] The

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[15]*See Amend. of Part 67,* 96 F.C.C.2d 781, 785 n.11 (1983).

[16]47 U.S.C. §220(a), (g), J.S. App. at A-133 - A-136. "Connecting carriers" are defined in Section 2(b) (2) of the Act, which excludes them from all FCC regulation except pursuant to Sections 201-205.

[17]47 U.S.C. §220(b), J.S. App. at A-133 - A-134.

[18]*See, e.g., South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Com'n,* 352 So.2d 964, 981 (La. 1977), *cert. denied* 437 U.S. 911 (1978).

[19]*See Washington Pub. Int. Org. v. Public Serv. Com'n,* 393 A.2d 71, 79-82 (D.C. App. (1978), *cert. denied,* 444 U. S. 926 (1979).

[20]*See Kansas City Southern Ry. Co. v. United States,* 231 U.S. 423, 442 (1913).

FCC argued this point after its uniform system was promulgated in 1935. The uniform system was attacked by a number of telephone companies that were concerned that amounts included in certain accounts, reflecting the difference between the "original cost" of assets and their cost of acquisition to the reporting utility, would be written off. The FCC assured this Court, however, that the reporting of plant costs would not necessarily determine their disposition.[21]

Consistent with the assurances given this Court, the FCC has never regarded the accounting reports as binding even for its own ratemaking. In 1956, when it approved changes in the accounting for certain operating expenses, the FCC stated that the proceeding involved "accounting, not rate making."[22] It added: "[W]e do not intend that this document should be construed as setting forth any opinion concerning the rate-making aspects of the items at issue."[23] In 1979, in a decision that harmonized the ratemaking and accounting treatment of construction work, the FCC stated: "[I]t is well established that accounting prescriptions are, in general, not conclusive as to substantive rights and do not govern the treatment of an account for ratemaking purposes. . . ."[24] Likewise, State courts and agencies have repeatedly held that the FCC

21 *American Tel. & Tel. Co. v. United States*, 299 U.S. 232 (1936). *See also* Kripke, *A Case Study in the Relationship of Law and Accounting: Uniform Accounts 100.5 and 107*, 57 HARV. L. REV. 433, 450-51 (1944).

22 *Amend. of Part 31*, 13 PUR3d 163, 167 (1956).

23 *Id.* at 168.

24 *American Tel. & Tel. Co.*, 72 F.C.C.2d 1, 5 (1979) (citations omitted).

uniform system of accounts is not determinative for ratemaking.[25]

State agencies often make ratemaking adjustments to the data reported pursuant to the FCC uniform system. The following adjustments are common, although they differ from uniform accounting prescriptions:

1) Capitalization of interest on short-term construction;
2) Capitalization of research and development costs;
3) Adjustment of depreciation rates;
4) Adjustment of expenses reported by companies, especially those resulting from affiliated transactions.[26]

The FCC has always been aware that many differences exist between its own accounting policies and the ratemaking practices of State agencies. Thus, when the FCC changed its uniform system in 1978 to authorize current earnings on short-term construction work, it stated:

25 *E.g., South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Com'n*, 352 So.2d 964, 981 (La. 1977), *cert. denied*, 437 U.S. 911 (1978); *Citizens v. Florida Pub. Serv. Com'n*, 415 So.2d 1268 (Fla. 1982); *see Washington Pub. Int. Org. v. Public Serv. Com'n*, 393 A.2d 71, 80 (D.C. App. 1978), *cert. denied*, 444 U. S. 926 (1979).

26 *See State ex rel Southwestern Bell Tel. Co. v. Public Serv. Com'n*, 645 S.W.2d 44, 52-54 (Mo.App. 1983) (short term construction); *South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Com'n*, 352 So.2d 964, 981 (La. 1977), *cert. denied*, 437 U.S. 911 (1978) (research and development); *Pacific Tel. & Tel. Co. v. Public Util. Com'n*, 401 P. 2d 353, 372-73 (Cal. 1965) (depreciation); *South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Com'n*, 373 So.2d 478, 487 (La. 1979) (expenses).

"We do not believe, nor is it intended, that the accounting changes adopted in this proceeding impinge upon the ratemaking prerogatives of any state commission. Further, as everyone is aware, different treatment is already given to a number of items for intrastate vs. interstate ratemaking . . . ."[27]

To the extent possible, the State agencies avoid requiring duplicative records.[28] Nevertheless, when ratemaking adjustments are made to accounts of utilities, separate records are often required to facilitate intrastate ratemaking. In some states, such as New York, the regulatory agency prescribes its own system of accounts.[29] The FCC has always acknowledged the need for separate intrastate records. When the FCC adopted its first uniform system of accounts in 1935, its order provided:

> Nothing herein contained shall be construed as prohibiting or excusing any such carrier . . . from subdividing the accounts herein prescribed in the manner ordered by any State commission having jurisdiction or to the extent necessary to secure the information required in the prescribed reports to such commissions.[30]

In 1941, the FCC incorporated a virtually identical provision in its regulations.[31] This provision remains in the Code to this day.

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[27] *Amend. of Part 31,* 68 F.C.C.2d 902, 906 (1978).

[28] Kripke, *supra* n.21 at 438 n.22 (1944).

[29] *See, e.g., Re Accounting Treatment,* 71 PUR3d 440 (N.Y.P.S.C. 1967); 16 N.Y.C.R.R. §660 *et. seq.* Wisconsin also has its own accounting system.

[30] *Accounting Rules for Telephone Companies,* 1 F.C.C. 45, 46 (1935) (Order No. 7-C).

[31] 47 C.F.R 31.01-2(f).

Under the FCC-prescribed uniform system of accounts, companies report their plant and expenses on a combined basis. Intrastate records are developed using the separations process to reflect intrastate operations.[32] To the extent that State ratemaking laws, regulations or requirements differ from accounting policies, and special records are needed for intrastate ratemaking, these subaccounts become part of the intrastate records.[33]

The 1935 uniform system of the FCC contained accounts for depreciation expense and accumulated depreciation, as well as instructions for developing depreciation rates. However, the FCC did not actively enforce its depreciation instructions on interstate plant until the 1940s. During that time, the States were exercising their authority to prescribe depreciation accrual rates for intrastate plant. After the FCC began exercising its authority, both the FCC and the States prescribed depreciation rates for their respective jurisdictions. In an effort to achieve uniformity, the FCC, State commissions and carriers began conducting three-way meetings to negotiate the depreciation rates for each State.[34] Agreements normally have been reached, but because the rates were negotiated, they nearly always have varied from State to State, even for the same company.[35]

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[32] *See* 47 C.F.R. Part 67 (1984).

[33] In States with their own uniform accounting systems, the State records are not really subaccounts, but separate State accounts.

[34] *See Prescription of Revised Percentages of Depreciation,* 88 F.C.C.2d 1223, 1225, 1230-31 (1982).

[35] *Id.* at 1248-1301.

When agreements have not been reached, the State agencies have used State-prescribed depreciation practices for intrastate ratemaking and carriers have maintained separate depreciation records pursuant to these practices.[36]

3. FCC proceedings below.

The FCC issued two orders in 1980 and 1981 to modify the accounting practices prescribed for carriers. In 1980, it amended 47 C.F.R. §31.02-80 to authorize carriers to begin using the "equal life group"and "remaining life" procedures in developing depreciation rates rather than the traditional "vintage group" and "whole life" procedures ("*Depreciation Order*").[37]

The *Depreciation Order* acknowledged that depreciation measures are inherently imprecise and require the exercise of judgment,[38] and that the issues are "complex and not readily characterized as 'right' or 'wrong.' "[39] In approving the equal life group method, the FCC permitted the new method *at the option of the carrier.*[40] The change to the remaining life method was also made optional.[41] The new depreciation methods allowed carriers to record increased depreciation expense on their accounts.

In 1981, the FCC modified the accounting method for station connection costs, requiring the expensing of these costs rather than the traditional capitalization

[36] *See, e.g., Pacific Tel. & Tel. Co. v. Public Util. Com'n,* 401 P.2d 353, 372-73 (Cal. 1965).

[37] *Amend. of Part 31,* 83 F.C.C.2d 267 (1980).

[38] 83 F.C.C.2d at 271, 280.

[39] *Id.* at 280.

[40] *Id.*

[41] *Id.* at 290.

costs rather than the traditional capitalization and depreciation of the expenditures ("*Expensing Order*").[42] This change is similar to the earlier ruling permitting the expensing rather than capitalization of interest on short-term construction.[43]

After the issuance of the *Expensing Order,* petitions were filed with the FCC seeking a clarification that it was not binding on State agencies for intrastate ratemaking.[44] The FCC responded with a decision that "state commissions are not precluded from using their own accounting and depreciation procedures for intrastate ratemaking purpose[s] . . . ."[45] It concluded that Section 220 of the Communications Act does not require State agencies to adhere to FCC-prescribed accounting and depreciation methods. It also ruled that preemption was not necessary to further any Federal policy. The FCC specifically noted that "[m]any states have adopted different accounting practices for intrastate ratemaking than those prescribed by the uniform system."[46]

The FCC reversed itself in its *Preemption Decision.*[47] Acting on petitions filed by telephone carriers, it determined that Section 220(b) of the Communications Act, which required the FCC to prescribe depreciation practices for carriers, precludes the States from departing from FCC depreciation rates in fixing intrastate rates.[48] In reaching its decision, the FCC characterized its *Expensing*

[42] *Amend. of Part 31,* 85 F.C.C.2d 818 (1981).

[43] *Amend. of Part 31,* 68 F.C.C.2d 902 (1978).

[44] *Amend. of Part 31,* 89 F.C.C.2d 1094 (1982), J.S. App. at A-61.

[45] *Id.* at 1095, J.S. App. at A-62.

[46] *Id.* at 1108-09, 1108 n.19, J.S. App. at A-84, A-81 - A-82 n.19.

[47] 92 F.C.C.2d 864 (1983), J.S. App. at A-24.

[48] *See Preemption Decision,* 92 F.C.C.2d at 879, J.S. App. at A-49.

Order as a depreciation decision. Although this ruling required the expensing rather than capitalization of station connection costs, the FCC called it a depreciation ruling because the plant would no longer be depreciable.[49] The FCC did not distinguish prior decisions permitting the expensing rather than capitalization of costs. For example, in its decision on short-term construction work, the FCC disclaimed any intent to bind intrastate ratemakers.[50]

Alternatively, the FCC determined that it would preempt inconsistent State depreciation practices under its general power to further a Federal policy.[51] The FCC concluded that it was necessary to preclude *any* State from applying inconsistent depreciation policies to any plant for intrastate ratemaking.

The Federal "policy" identified by the FCC as served by preemption was a need for faster capital recovery in a "competitive environment" to encourage innovation and better allow carriers "to fully compete in the continually evolving telecommunications marketplace."[52] The alleged analysis of the impact on competition consisted of a series of speculations as to possible consequences of inconsistent State practices. The FCC found that slower capital recovery "could delay or prevent" modernization.[53] It also found that slower capital recovery "could well impair" capital attraction, which then "could undermine" the objective of developing an efficient telecommunications

[49]*Id.* at 868, J.S. App. at A-30 - A-31.

[50]*Amend. of Part 31,* 68 F.C.C.2d 902 (1978).

[51]*Preemption Decision,* 92 F.C.C.2d at 875-78, J.S. App. at A-42 - A-48.

[52]*Id.* at 877, J.S. App. at A-45 - A-46.

[53]*Id.*

market place.[54] The FCC made no empirical analysis quantifying, or even approximating, the effect of its new accounting methods on capital recovery.[57] Nor did the FCC explain why local exchange carriers providing monopoly services, subject to regulation, should be provided capital recovery permitting them to "compete" in the "telecommunications marketplace."[56]

The *Preemption Decision* voided State depreciation rates, policies and accounting practices different from those that carriers were permitted to adopt pursuant to the *Depreciation Order* and *Expensing Order.*[57] The FCC also indicated a belief that *all* Federal accounting and depreciation policies are preemptive.[58] It said: "[W]e will not allow inconsistent accounting or depreciation methods unless such practices are otherwise consistent with the public interest."[59]

The *Preemption Decision* allows carriers to record higher expenses for the expensing of station connections and faster depreciation in many States, and precludes State commissions from adjusting the accounts for intrastate ratemaking. Rate increases are therefore required to match the increased expenses, at least in States where

[54]*Id.* at 877, J.S. App. at A-46.

[55]*See Preemption Decision,* 92 F.C.C.2d at 876-78, J.S. App. at A-46 -A-48.

[56]*See Preemption Decision,* 92 F.C.C.2d at 877, J.S. App. at A-46.

[57]*Id.* at 879, J.S. App. at A-49.

[58]*Id.* at 873-74, J.S. App. at A-39 -A-40.

[59]*Id.* at 873-74, J.S. App. at A-40.

faster capital recovery had not already been allowed.[60] In a number of Federal court enforcement proceedings, the States have been required to grant rate increases to comply with the ruling.[61]

4. Ruling of the court of appeals.

A petition for review of the *Preemption Decision* was filed by the Virginia State Corporation Commission in the court of appeals.[62] A number of States, State regulatory agencies and consumer advocates intervened in support of the petitioner. The court of appeals declined to decide whether the language of the Communications Act requires preemption.[63] Instead, in a 2-1 decision, it ruled that the "regulatory action" of the FCC was justified as "within its authority to ensure efficient operation of the interstate telephone network."[64]

Although the court of appeals recognized that Sections 152(b) and 221(b) of the Communications Act "reserve to the states the authority to prescribe rates for intrastate telephone service,"[65] it determined that these provisions are outweighed by the "primary emphasis upon

[60]In states such as Florida, which have rejected FCC depreciation policy but have other, more generous depreciation policies than the FCC, the affected carriers have not chosen to enforce the *Preemption Decision.*

[61]*E.g., South Central Bell Telephone Co. v. Louisiana Pub. Serv. Com'n.*, 744 F.2d 1107 (5th Cir. 1984); *appeal docketed,* No. 84-870 (U.S., Nov. 30, 1984).

[62]*Virginia State Corp. Com'n v. F.C.C.*, 737 F.2d 388 (4th Cir. 1984), J.S. App. at A-1.

[63]*Id.* at 392, J.S. App. at A-8.

[64]*Id.* at 394, J.S. App. at A-11.

[65]*Id.* at 392, J.S. App. at A-8.

a 'rapid, efficient, Nationwide, and world-wide' communication service."[66] According to the court, this "overriding concern,"[67] which is contained in the "purpose"[68] section of the Communications Act, permits the FCC to override the specific statutory reservation of power to the States.

The court of appeals employed a two-step analysis, based on *Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta,*[69] in approving preemption. First, it found that the FCC intended to preempt.[70] Second, it found that since the FCC is authorized by Section 220(b) to prescribe depreciation rates, the FCC acted within its power in requiring the States to raise intrastate rates for increased depreciation.[71] In applying the two-step analysis, the court of appeals gave no weight to the statutory provisions reserving ratemaking power to the States. The court of appeals accepted, without scrutiny, the FCC contention that "improper capital recovery does pose a true threat in today's competitive market."[72]

Judge Widener, in dissent, determined that the FCC and the majority had "effectively written 47 U.S.C. §§152(b) and 221(b) out of the Communications Act."[73] He added: "The logical result of this decision is to permit the

[66]*Id.*

[67]*Id.*

[68]47 U.S.C. §151, J.S. App. at A-131.

[69]458 U.S. 141 (1982).

[70]737 F.2d at 393-94, J.S. App. at A-11.

[71]*Id.* at 394, J.S. App. at A-11.

[72]*Id.* at 394, J.S. App. at A-12.

[73]*Id.* at 398, J.S. App. at A-21.

FCC to abrogate completely the state regulation of intrastate ratemaking for the carriers' intrastate operations in violation of the Communications Act."[74] The dissenting judge also observed that the asserted "threat" to competition was mere "theorizing."[75] He noted that the FCC had failed to show the relationship between the capital recovery of regulated monopoly carriers and the competitive abilities of unregulated carriers.[76]

The *Preemption Decision* was interpreted by the United States Court of Appeals for the Fifth Circuit in a proceeding to enforce the FCC ruling.[77] The court upheld an injunction requiring a dollar-specific intrastate rate increase and precluding the Louisiana Commission from adjusting a previously authorized rate of return. The court stated that the "Preemption Order comes perilously close to undermining completely state authority and discretion to set intrastate rates . . . ."[78]

The *Preemption Decision* had a significant impact on intrastate rates. The Louisiana Commission, for instance, was required in the enforcement proceeding to raise intrastate rates by more than $40 million to comply with the decision.[79] In its most recent rate order involving South

[74] *Id.* at 398, J.S. App. at A-22.

[75] *Id.* at 398, J.S. App. at A-20.

[76] *Id.* at 398, J.S. App. at A-20 - 21.

[77] *South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Com'n*, 744 F.2d 1107 (5th Cir. 1984).

[78] *Id.* at 1121.

[79] *South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Com'n*, 570 F. Supp. 227 (M.D. La. 1983); *aff'd* 744 F.2d 1107 (5th Cir. 1984).

Central Bell Telephone Company, the Louisiana Commission determined that the *Preemption Decision* required $62.7 million of the total increase in revenues for the company.[80] If the *Preemption Decision* were implemented in Ohio in 1985, the impact on rates charged by the three major telephone companies could be as much as $64 million annually.[81]

The Florida Commission has rejected the equal life group method but nevertheless permits equivalent capital recovery to that prescribed by the FCC. Ironically, since no carrier chooses to enforce the FCC method, Florida depreciation for the present is based on the intrastate ratemaking practice.

ARGUMENT

Summary of the Argument

1. The ruling of the court of appeals approves the conscription of State regulatory officials to raise intrastate telephone rates. The decision is based on an incorrect interpretation of *Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta*[82] and other preemption decisions of this Court. The analysis of the court of appeals focused on language describing the general purpose of the Communications Act, but gave no weight to provisions reserving intrastate ratemaking to the States. The ruling permits a Federal agency, in pursuit of an agency-created "policy," to override statutory boundary lines and, without authority, displace State law.

2. The *Preemption Decision* requires rate increases to

[80] *Ex parte South Cent. Bell Tel. Co.*, Order No. U-15995-A (La. P.S.C., 1984), J.S. App. at A-112, A-120.

[81] *Re General Tel. Co. of Ohio*, No. 84-1026-TP-AIR (P.U.C. Ohio); *Re Cincinnati Bell Tel. Co.*, No.84-1272-TP-AIR (P.U.C. Ohio); *Re Ohio Bell Tel. Co.*, No. 84-1435-TP-AIR (P.U.C. Ohio).

[82] 458 U.S. 141 (1982).

comport with the new FCC accounting and depreciation policies. Therefore, it conflicts with explicit provisions of the Communications Act. The Act limits the reach of FCC jurisdiction to interstate communications and grants autonomy to the States in regulating intrastate communications. The statute contemplates the separation of the interstate and intrastate plant and expenses of telephone carriers for regulatory purposes. It also recognizes that separate records may be necessary for intrastate accounting and ratemaking. By requiring State agencies to increase rates to conform with Federal accounting and depreciation practices, the FCC has undertaken an unauthorized foray beyond its regulatory jurisdiction and has entered a province reserved to the States by Congress.

3. Section 220 of the Communications Act, which permits the FCC to prescribe a system of accounts for telephone carriers, does not authorize the FCC to order intrastate rate increases. Section 220 was intended to foster uniform *reporting* of the affairs of carriers; it does not require uniform ratemaking. The FCC never previously viewed its accounting prescriptions as binding on the States, or even on itself, for ratemaking. Courts and regulatory agencies have consistently held that uniform accounting practices do not control ratemaking. No basis exists for the attempt by the FCC to transform a *reporting* provision into authority for setting intrastate rates.

4. The legislative history of the Communications Act confirms that Congress intended to preclude the FCC from engaging in intrastate ratemaking. The sponsors of the Communications Act repeatedly stated their intent to preserve State ratemaking autonomy. Congress rejected a version of Section 220(j) that implied that the States were denied the power to prescribe rates. Congress also decided not to include a version specifically reserving State authority, but this section was unnecessary. Ratemaking jurisdiction had already been reserved to the States. In the

final version of Section 220(j), Congress retained the prerogative to enact legislation to harmonize interstate and intrastate accounting. It thus denied the FCC the discretion to preempt State practices.

In addition, five decades of administrative practice confirm the Congressional intent to preserve State ratemaking autonomy. The plant and expenses of carriers have been divided, for ratemaking, in the separations process. The States have always been free to adjust data reported on the accounts of carriers for ratemaking, and dual records, including dual depreciation accounts, have been maintained for decades by carriers to facilitate ratemaking adjustments.

5. Since State ratemaking authority is protected by a federal statute, the only conceivable rationale for approving preemption would be the impossibility of reconciling the limiting provisions with other statutory provisions. The impossibility rationale was the underlying basis for past decisions of lower courts approving preemption by the FCC in other contexts. In this case, it is possible to divide ratemaking responsibilities and they have been divided for decades using the separations process. The division follows the Congressional plan. In addition, the so-called "conflict" identified by the FCC is based wholly on speculation and could not provide a valid basis for ignoring Congressional intent.

6. The Court has jurisdiction of the appeal taken by the Louisiana Commission pursuant to 28 U.S.C. §1254(2), which permits appeals to the Court when State laws are invalidated on Federal constitutional grounds. The decision of the court of appeals affirmed a ruling that invalidates State ratemaking orders, which are considered statutes for the purpose of 28 U.S.C. §1254(2). Therefore, the Court should find that its appellate jurisdiction was properly invoked.

I. THE *PREEMPTION DECISION* IMPROPERLY SUBVERTS THE INTENT OF CONGRESS TO PRESERVE STATE AUTHORITY OVER INTRASTATE TELEPHONE COMMUNICATIONS.

In mandating that State regulators increase intrastate telephone rates to conform to Federal accounting prescriptions, the FCC invaded the authority reserved to the States in the Communications Act. In the statute, Congress expressly prohibited the FCC from regulating intrastate telephone communications and, particularly, intrastate rates. The legislative history and five decades of administrative practice confirm this Congressional intent. Section 220 of the Act. which is a reporting rather than a ratemaking provision, provides no support for the FCC action. Since the separations process provides for the coexistence of Federal and State ratemaking practices, there is no "impossibility" argument for reading away the provisions protecting intrastate authority. Therefore, the *Preemption Decision* is invalid.

The court of appeals purportedly applied the preemption standard announced by this Court in *Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta*[83] in upholding the *Preemption Decision.* The *de la Cuesta* test for preemption is: first, whether the agency intended to preempt state law; and, second, whether the agency action was within the scope of the agency's delegated authority.[84] However, in mechanically applying this Court's two-part test, the court of appeals ignored the restrictions on FCC jurisdiction contained in the Communications Act, contrary to *de la Cuesta.* Indeed, this Court reaffirmed that the agency must respect boundary lines set by Congress. It held that a

[83]458 U.S. 141 (1982).

[84]*Id.* at 154.

preemptive decision should be overruled when " 'it appears from the statute or its legislative history that the [preemption] is not one that Congress would have sanctioned' "[85] or when it is " 'inconsistent with' "[86] the underlying statute. To determine whether the agency had discretion to act as it did, the Court in *de la Cuesta* reviewed the language and legislative history of the statute in question.[87]

Here, the court of appeals was not faithful to this analysis. With respect to the first part of the *de la Cuesta* test, it correctly found that the FCC intended to preempt.[88] With respect to the second part, the court accepted, without question, the FCC's assertion that its action was authorized because it was necessary to further a federal policy.[89] The court of appeals focused on general "purpose" language in the Act, but refused to give meaning to sections preserving State jurisdiction. It also ignored the legislative history of the Act and nearly fifty years of practice. The court found the *Preemption Decision* permissible based on this faulty analysis. The ruling of the court of appeals is deficient because *de la Cuesta* requires respect for Congressional boundary lines.

[85]*Id.*, quoting *United States v. Shimer,* 367 U.S. 374, 383 (1961).

[86]*Id.*, quoting *Free v. Bland,* 369 U.S. 663, 668 (1962).

[87]*Id.* at 159 *et seq.*

[88]737 F.2d at 393, J.S. App. at A-9 - A-10.

[89]*Id.* at 395, J. S. App. at A-12 - A-14.

A. The FCC Requirement that State Agencies Increase Intrastate Telephone Rates is Contrary to the Express Statutory Reservation of Intrastate Authority to the States.

The Communications Act specifically precludes the FCC from regulating any aspect of intrastate telephone communication. Section 2(b) of the Act is a broad provision reserving State authority:

> *[N]othing* in this chapter shall be construed to apply or to give the commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier . . . .[90]

This language preserves the authority of State agencies over all intrastate charges and intrastate ratemaking practices. Since it appears in the section entitled "APPLICATION OF ACT," it controls all of the provisions granting affirmative authority to the FCC. This provision is the cornerstone of a detailed Congressional plan for dividing Federal and State regulatory authority.[91]

In addition, Congress chose to permit State regulation of certain aspects of interstate communication. Section 3(e), which defines "[i]nterstate communication" and "interstate transmission," and therefore determines that reach of FCC power,[92] states that these terms "shall not . . . include wire or radio communication between points

[90] 47 U.S.C. §152(b), J.S. App. at A-132 *(emphasis added).*

[91] *See* 47 U.S.C. §§203(a), 213(h), 214(a) and 221(a), (c), (d). *See also* 47 U.S.C. §§153(r), (u).

[92] *See* 47 U.S.C. §§151, 152(a), J.S. App. at A-131.

in the same State . . . through any place outside thereof, if such communication is regulated by a State commission."[93] Section 221(b) also reserves jurisdiction to the States over exchange service "subject to regulation by a State commission or by local governmental authority," even when a "portion of such exchange service constitutes interstate or foreign communication."[94]

These provisions establish a clear intent to separate the interstate and intrastate regulatory jurisdictions, and preclude the FCC from regulating intrastate rates. Yet the *Preemption Decision,* when enforced by carriers, requires State regulators to adjust intrastate rates. Since the FCC ruling contravenes the Communications Act, it is not within the preemptive power delegated to the agency.

The *Preemption Decision* runs counter to the statutory provisions for the separation of interstate and intrastate telephone plant and expenses for ratemaking. These provisions provide an administrative mechanism for implementing the separations principle announced by this Court in *Smith v. Illinois Bell Tel. Co.*[95] Section 221(c) of the Act provides that the FCC may "determine what property of [a carrier] shall be considered as used in interstate or foreign telephone toll service."[96] Section 410(c), passed in 1971, provides for joint board proceedings to develop separations procedures.[97] As the Senate Report on the

[93] 47 U.S.C. §153(e), J.S. App. at A-132 - A-133.

[94] 47 U.S.C. §221(b), J.S. App. at A-136 - A-137.

[95] 282 U.S. 133 (1930).

[96] 47 U.S.C. §221(c), J.S. App. at A-137.

[97] 47 U.S.C. §410(c), J.S. App. at A-138 - A-139.

1971 Act stated, the "allocations must be reasonable, i.e., the rate base for each jurisdiction must have appropriate correlation to the different uses of the commonly used plant."[98] Thus, the statute contemplates that the separations process will determine the limits of Federal and State ratemaking jurisdiction pursuant to the mandate of *Illinois Bell.*[99] The *Preemption Decision* violates this division of authority.

The decision of the court of appeals is also contrary to Section 410(b) of the Communications Act, in which Congress expressly contemplated that State commissions would maintain separate records from those of the FCC for ratemaking.[100] This section provides that the Commission may confer with State commissions concerning the relationship of Federal and State rate structures, accounts, practices and classifications and may avail itself of records provided by State commissions. If Congress had intended that only the FCC could require record keeping by telephone carriers, this provision would not have been included in the Act.

The court of appeals circumvented the provisions preserving State authority by focusing primarily on general "purpose" language in Section 151 of the Act. This approach violates established principles of statutory construction. The analysis must involve review of the statutory whole and not the selection of provisions out of context, so that "all parts of a statute, if possible, are to

[98]S. Rep. No. 92-632, 92d Cong., 1st Sess., *reprinted in* 1971 U.S. Code Cong. & Ad. News 1511, at 1512.

[99]282 U. S. at 149.

[100]47 U.S.C. §410(b), J.S. App. at A-138.

be given effect." *American Textile Mfr. Inst., Inc. v. Donovan.*[101] If an ambiguity appears to exist, each provision should be read as being in harmony with the others, so as not to create a conflict. *Washington Market Co. v. Hoffman.*[102] The provisions should not be read to render the statute partly ineffective or inefficient. *United States v. Powers.*[103]

Applying these principles, the court of appeals misapplied *de la Cuesta.* Congress may have established the general goal "to make available . . . a rapid, efficient, Nation-wide, and world-wide wire . . . communication service . . . ,"[104] but it enacted a dual regulatory system to achieve that goal, reserving intrastate jurisdiction to the States. The court's narrow focus on Section 151 eliminated boundary lines written into other sections. This approach is erroneous, because *de la Cuesta* does not suggest that a court may ignore limiting provisions in a statute.

Although the FCC and the court of appeals referred to Section 220(b) as supporting the *Preemption Decision,*[105] Section 220(b) and the other provisions of Section 220 merely permit the FCC to prescribe methods for *reporting* the financial affairs of carriers. They do not authorize

[101]452 U.S. 490, 513 (1981).

[102]101 U.S. 112 (1879).

[103]307 U.S. 214, 217 (1983).

[104]47 U.S.C. §151, J.S. App. at A-131.

[105]*Preemption Decision,* 92 F.C.C. 2d at 869-70, J.S. App. at A-31 - A-33; *Virginia State Corp. Com'n v. F.C.C.,* 737 F.2d 388, 394 (4th Cir. 1984), J.S. App. at A-11.

the FCC to set intrastate rates. Therefore, no statutory authorization supports the agency action.

Section 220 was based on Section 20 of the Interstate Commerce Act, which was passed because the accounting systems of carriers had not been uniform. As this Court stated in 1913 in upholding Section 20, Congress "manifested a purpose to standarize and render uniform the accounts of the different carriers." *Kansas City Southern Ry. Co. v. United States.*[106] Section 220 of the Communications Act also was a reporting provision. Indeed, when the FCC initially prescribed its uniform system of accounts pursuant to this section, it assured this Court that the reporting requirements would not necessarily determine the ultimate disposition of assets.[107] Since then, the FCC has consistently maintained that its accounting prescriptions are not binding for ratemaking.[108] As the FCC stated in 1979, it "is well established that accounting prescriptions . . . do not govern the treatment of an account for ratemaking purposes . . . ."[109] In its first ruling on the preemption issue, the FCC acknowledged that administrative agencies and courts uniformly held for four decades that Section 220 does not inhibit State ratemaking prerogatives.[110]

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[106]231 U.S. 423, 442 (1913).

[107]*American Tel. & Tel. Co. v. United States*, 299 U.S. 232 (1936).

[108]*Amend. of Part 31*, 13 PUR3d 163, 167 (1956); *American Tel. & Tel. Co.*, 64 F.C.C.2d 1, 56-60, 62, 68 (1977).

[109]*American Tel. & Tel. Co.*, 72 F.C.C.2d 1, 5 (1979).

[110]*Amend. of Part 31*, 89 F.C.C.2d 1094, 1107 (1982), J.S. App. at A-83.

Decisions of State courts and administrative agencies consistently hold that the accounting provisions of the FCC are not binding for intrastate ratemaking. For instance, the District of Columbia Court of Appeals made an extensive analysis of the history of the Communications Act and determined that the uniform accounting system "merely was a system of notation, without substantive significance." *Washington Pub. Int. Org. v. Public Serv. Com'n.*[111] The court held that uniform accounting precepts of federal agencies are not binding for ratemaking. In addition, the Supreme Court of California ruled that the California Commission was "not bound by the depreciation rates or methods set by the Federal Communications Commission." *Pacific Tel. & Tel. Co. v. Public Util. Com'n.*[112]

The Louisiana Supreme Court also has held that the uniform accounts of the FCC are not binding. In upholding a decision to capitalize costs that were expensed under the uniform system, it said: "The fact that capitalization of research costs may not accord with accounting practices prescribed by the F.C.C. does not necessarily render it unreasonable." *South Cent. Bell Tel. Co. v. Louisiana Pub. Serv. Com'n.*[113] The conclusion that federal accounting precepts are not binding for intrastate ratemaking appears to be universally shared by state courts and regulatory agencies.[114]

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[111]393 A.2d 71, 80 (D.C. App. 1978), *cert.denied*, 444 U.S. 926 (1979).

[112]401 P.2d 353, 372-73 (1965).

[113]352 So.2d 964, 981 (La. 1977), *cert. denied*, 437 U.S. 911 (1978).

[114]*New England Tel. & Tel. Co. v. Public Util. Com'n*, 448 A.2d 272, 293 (Maine 1982); *State ex rel Southwestern Bell Tel. Co. v. Public Serv. Com'n*, 645 S.W.2d 44, 54-56 (Mo.App. 1983); *Washington Util. and Transp. Com'n v. Pacific Northwest Bell Tel. Co.*, 39 PUR4th 126, 135-36 (Wash. U.T.C., 1980); *Southwestern Bell Tel. Co.*, 36 PUR4th 283, 294 (Mo. P.S.C., 1980); *Re Accounting Treatment*, 71 PUR3d 440, 442 (N.Y. P.S.C., 1967); *Southern Bell Tel. & Tel. Co.*, 66 PUR3d 1, 58 (Fla. P.S.C., 1966).

The federal courts of appeals have recognized the universal regulatory principle that accounting precepts cannot dictate ratemaking in reviewing decisions of the Federal Power Commission and its successor, the Federal Energy Regulatory Commission. In *Alabama-Tennessee Nat. Gas Co. v. F.P.C.*, the Fifth Circuit ruled that the FPC uniform system was a valuable tool, but it "cannot dictate ratemaking policies."[115] The District of Columbia Circuit and the Fourth Circuit have reached similar conclusions.[116]

Section 220 does not authorize the FCC to prescribe ratemaking practices for the States. This provision is designed to bring about uniform reporting, not uniform ratemaking. As a reporting provision, Section 220 is wholly consistent with the sections preserving State ratemaking jurisdiction, especially since Section 221(c) contemplates separation of interstate and intrastate plant for ratemaking and Section 410(b) recognizes that separate State records may be maintained to facilitate intrastate ratemaking.

The reliance on Section 220(b) is also unjustified because Section 220(j) precludes FCC discretion to preempt State depreciation and accounting. It directs the FCC to report to Congress on the need for legislation to harmonize State and Federal powers over accounting and depreciation. Thus, Congress reserved to itself, and denied the FCC, the power to change the relationship of Federal and State authority under Section 220.

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[115]359 F.2d 318, 336 (5th Cir. 1966).

[116]*Public Systems v. F.E.R.C.*, 606 F.2d 973, 982 (D.C. Cir. 1979) ("[D]espite the obvious relevance of accounting precepts for some regulatory policies, they cannot supply an independent basis for action when they may conflict with established ratemaking principles."); *Consolidated Gas Supply Corp. v. F.E.R.C.*, 653 F.2d 129, 135 (4th Cir. 1981). *See also* A.J.G. PRIEST, PRINCIPLES OF PUBLIC UTILITY REGULATION 611 (1969).

The use of the reporting authorization to force intrastate rate increases produces an especially egregious interference with intrastate prerogatives. Since carriers report *all* their investment and expenses using the FCC uniform system, their accounts include purely intrastate plant, as well as the intrastate portion of jointly used plant. The *Preemption Decision* requires the use of the FCC depreciation methods for ratemaking even with respect to the purely intrastate plant.

The FCC decision to delegate to carriers the right to preempt State ratemaking adds an ironic twist to the subversion of Congressional intent. By giving carriers the option of adopting faster depreciation methods in the *Depreciation Order*, then preempting inconsistent State rules, the FCC allowed the carriers to decide whether State depreciation practices are displaced. This assignment of preemptive power permits the carriers to dictate to State regulators — a result that Congress did not intend. Even if the FCC had preemptive power, the Communications Act does not permit its delegation to the regulated telephone companies.[117]

The cavalier treatment of specific statutory limits by the court of appeals obliterates a premise of preemption theory. In *Garcia v. San Antonio Met. Transit Auth.*,[118] this Court examined affirmative limits on Congressional power under the Commerce Clause.[119] It found that "the principal and basic limit on the federal commerce power is

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[117]*Cf. Greene County Plan. Bd. v. F.P.C.*, 455 F.2d 412, 420 (D.C. Cir. 1972), *cert. denied*, 409 U.S. 849 (1972).

[118]105 S.Ct. 1005 (1985).

[119]U. S. Const. art. I, §8.

that inherent in all congressional action — the built-in restraints that our system provides through state participation in federal governmental action."[120] Thus, a true implementation of Congressional intent is critical in order to afford States the procedural safeguards upon which *Garcia* rests. If the FCC is permitted to read away limiting provisions of the Act, then the basic safeguard for State authority has been eliminated.

The *Preemption Decision* is an unauthorized usurpation of the authority reserved by Congress to the States. Congress contemplated that Federal and State ratemaking authority would be divided using the separations process, and that the FCC should not invade the intrastate realm. The Act contains no affirmative authority for overriding the Congressional scheme. Therefore, the ruling should be reversed.

B. The Legislative History of the Communications Act and the History of Its Implementation Confirm Congressional Intent to Limit the Jurisdiction of the FCC and Preserve State Autonomy Over Intrastate Communications.

In preemption cases the Court has looked to legislative history to determine the intent of Congress.[121] Had the court of appeals analyzed the legislative history, this review would have shown that Congress intended to preclude the FCC from engaging in intrastate ratemaking.

[120] 105 S.Ct. at 1020.

[121] *Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 163-67 (1982).

The legislative history of the Communications Act of 1934 demonstrates that Congress had a clear, unequivocal intent to limit FCC authority and preserve State autonomy over intrastate communications. Indeed, the foremost concern of Congress in enacting Title II of the Act was the division of Federal and State authority. This one aspect of telephone regulation received more attention than any other during hearings, in reports and during floor debates. With respect to Section 220, the legislative history demonstrates that Congress did not intend to preempt State authority over accounting or depreciation rates. It intended that any conflict between Federal and State authority be resolved by legislation. Fifty years of administrative practice, in which FCC accounting practices were never seen as binding for intrastate ratemaking, confirm the workability of the Congressional plan.

Bills introduced in both the House and Senate contained provisions limiting FCC authority and preserving State autonomy over intrastate communications.[122] These provisions were apparently drafted with the aid of representatives of State regulatory agencies.[123] The central limiting provisions were ultimately enacted as Sections 2(b) and 221(b) of the Act. These sections reserve to the States all authority to regulate intrastate communications and were strongly supported during committee hearings.

[122] The bills were designated S. 2910 and H.R. 8301. The limiting provisions in S. 2910 were contained in sections 2, 3(e), 210, 220(j) and 221(a)(b)(c) & (d). The limiting provisions in H.R. 8301 were contained in Sections 2, 3(e), 210, 214(e), 220(j) and 221(a)(b)(c) & (d).

[123] See statement of Chairman Dill, Hearings on S. 2910 before the Senate Committee on Interstate Commerce, 73d Cong., 2d Sess. ("Sen. Comm. Hearings") at 179 (1934).

Representatives of the National Association of Railroad and Utility Commissioners ("NARUC") appeared on behalf of State regulatory agencies and urged passage of the bills with the limiting language intact.[124] The States were concerned that a new commission would effectively eliminate meaningful regulation by the States, if it exerted the broad authority of the ICC without limiting provisions.

NARUC emphasized that the States were not wedded to any specific language, but advocated language that would prevent their authority from being eroded.[125] The independent telephone companies supported the provisions limiting FCC authority and, in addition, proposed that local telephone companies carrying interstate calls only via connection to the Bell network, be exempted from FCC authority.[126]

There was little controversy over the proposed division of Federal and State authority. AT&T briefly urged a simple transfer of authority from the ICC to the new Commission.[127] The Senate Committee received suggestions that S. 2910 should be amended to expressly extend FCC authority to the entire communications network.[128] In written comments, a representative of the ICC advised

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[124]*See* Statements of Messrs. Benton, Clardy and McDonald, Sen. Comm. Hearings at 153-155, 155-157 and 178-184; Hearings on H.R. 8301 before the House Committee on Interstate and Foreign Commerce, 73rd Cong., 2d Sess. ("H.R. Comm. Hearings"), at 70-74, 131-147 (1934).

[125]Sen. Comm. Hearings at 154-55, 179-80; H.R. Comm. Hearings at 71, 73, 136, 132.

[126]*See* comments of Messrs. MacKinnon, Derring, Hedreck, and McKinney, H.R. Comm. Hearings at 239, 241, 248, 252, 254 and 273.

[127]*See* Sen. Comm. Hearings at 77, 213-16.

[128]*See* Comments of Messrs. McDonough and Nockels, Sen. Comm. Hearings at 114-16, 199.

that subsection 221(b) might result in ineffective interstate regulation.[129] However, both committees and, ultimately, both houses of Congress agreed to the division of Federal and State authority as proposed and adopted provisions that further limited FCC authority.

The Senate Committee on Interstate Commerce endorsed the division of Federal and State authority and rejected the simple transfer of authority from the ICC.[130] Its report noted that Section 2 of the bill reserved exclusive State jurisdiction over intrastate communication.[131] On the Senate floor, Senator Dill emphasized that the bill *preserved* State authority to regulate intrastate communications.[132]

The House report also endorsed the division of Federal and State authority in H.R. 8301.[133] Among other things, the House report noted that subsection 2(b) exempts the intrastate business of any carrier.[134] On the House floor, Representative Rayburn noted that the bill preserved State authority over intrastate communications.[135] H.R. 8301 was passed by the House without amendment as a substitute for S. 3285.[136]

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[129]Sen. Comm. Hearings at 209, H.R. Comm. Hearings at 97.

[130]S.Rep. No. 781, 73rd Cong., 2d Sess., at 1-2 (1934) ("S.Rep."). The report proposed to substitute S. 3285 in favor of S. 2910, but retained the division of authority in S. 2910.

[131]S.Rep. at 3.

[132]78 Cong. Rec. 8823 (1934).

[133]*Id.* at 8846. One amendment changed subsection 2(h) to further exempt local companies that carried interstate calls only by connection to carriers with which they were not affiliated.

[134]H.R. Rep. No. 1850, 73rd Cong., 2d Sess. (1934) ("H.R. Rep.").

[136]78 Cong. Rec. 10313, 10314 (1934).

A conference committee was authorized to settle the differences between S. 3285 and H.R. 8301. As ultimately proposed by the conference committee and approved by each House, the Act contained ten provisions that limited FCC jurisdiction and preserved State autonomy over intrastate communications.[137]

Congress fully and carefully considered the scope of FCC authority and intended to limit FCC authority in favor of State autonomy over intrastate and local communication. The decision of the court of appeals flies in the face of the clear intent of Congress that the FCC could not preempt any State regulation of intrastate communication that simply affects an FCC interstate policy. Had Congress intended to permit the FCC to supercede State regulation, it would have simply transferred the ICC's power to the FCC. Instead, it explicitly preserved State autonomy.

Congress understood that State regulation would affect federal policy. That is the very basis of the *Shreveport Rate Case*, where intrastate rates were raised to the level prescribed by the ICC to avoid discrimination.[138] In enacting provisions to insulate State regulation and prevent a Federal determination of intrastate rates, Congress overruled the *Shreveport Rate Case*.[139] Congress' thoughtful, deliberate decision to permit a diverse array of regulatory policies belies any intent to permit preemption of State regulation to advance an agency policy.

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[137] These provisions were contained in subsections 2(b) (1), 2(b) (2), 3(e), 203(a), 213(h), 214(a) and 221(a)(b)(c) and (d).

[138] *Houston, E. & W. Texas Ry. v. United States*, 234 U.S. 342 (1914).

[139] *See North Carolina Util. Com'n v. F.C.C.*, 552 F. 2d 1036, 1047 (4th Cir.1977), *cert. denied*, 434 U.S. 874 (1977).

The *Preemption Decision* also conflicts with the legislative history of Section 220. As originally drafted, subsections (h)-(j) of Section 220 explicitly preserved State autonomy over systems of accounts and depreciation. NARUC endorsed subsection (j), which preserved State discretion to prescribe depreciation rates and forms of accounts, but did not urge adoption of its specific terms. The States sought language preserving their authority to obtain data needed for intrastate purposes and to review a carrier's depreciation rates when setting intrastate rates.[140]

AT&T vigorously attacked subsections (h) and (j). It urged that subsection (h) would permit the FCC to dismantle the existing uniform system of accounts and that subsection (j) would create an impossible situation for multistate companies.[141] AT&T never contended, however, that the States should be limited in their ability to obtain data or hindered in their intrastate ratemaking.[142] In written comments, a representative of the ICC advised that subsection (j) conflicted with the uniformity of systems of accounts and depreciation accounting required by subsection 220.[143]

NARUC, on the other hand, merely sought to ensure that the States could obtain data in addition to the FCC uniform system of accounts. It never endorsed multiple systems of accounts. In fact, it predicted that State participation under subsection (i) would lead to a uniform system that would fulfill many of the needs of the States. As far as depreciation was concerned, NARUC really only

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[140] H.R. Comm. Hearings at 138, 144, 143.

[141] *See* Sen. Comm. Hearings at 96, H.R. Comm. Hearings at 191.

[142] *See* comments of Walter S. Gifford, Sen. Comm. Hearings at 94-97; H.R. Comm. Hearings at 189-92.

[143] Sen. Comm Hearings at 208; H.R. Comm. Hearings at 96.

sought assurance that the States would remain unhindered in reviewing depreciation rates for intrastate ratemaking. The ICC had never prescribed depreciation rates for any telephone company. Instead, the individual States had been doing it, without any complaint from AT&T.[144]

In sum, AT&T sought uniform accounting and NARUC agreed to uniform accounting. Likewise, NARUC sought independent accounting and ratemaking authority and AT&T endorsed subaccounts which allow that. The States were reviewing depreciation rates and AT&T did not suggest that this practice should be prohibited.

The Senate rejected subsections (h) and (j) as drafted and amended those provisions to instruct the FCC to make further recommendations as to whether Congress should pass legislation to *permit* the State commissions to prescribe their own accounting and depreciation practices. On the other hand, the House retained the original language of subsections 220(h) and (j). The Conference Committee sided with the House on subsection (h) and rejected both versions of subsection (j) in favor of a modified version:

> The Commission shall investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the Commission and of State Commissions with respect to matters to which this section relates.[145]

The final version of subsection (j) retains the Senate's direction that the FCC report on the need for legislation. However, it omits the language in the Senate's version suggesting that Section 220 preempts as a matter

[144]*See* H.R. Comm. Hearings at 140-44.

[145]47 U.S.C. §220(j), J.S. App. at A-136.

of law. Further, the section implies that the States may exercise "powers" with respect to accounting and depreciation. Had Congress intended to withhold State authority it would have adopted subsection (j) as passed by the Senate. Instead, the Conference Committee intended that State and Federal authority over accounting and depreciation be harmonized so that both interests could be preserved.

The Conference Committee had every reason to expect a harmonious exercise of FCC and State powers under a uniform system of accounts that accommodated the needs of the States. Subsection (i) required the FCC to receive and consider State commission comments, no doubt so that its uniform system would require data sought by the States or accommodate additional State requirements. Different accounting requirements, including different depreciation rates, could be accommodated in subaccounts. Nevertheless, since the system was as yet untried, subsection 220(j) directed the FCC to report on the need for legislation to further define or harmonize Federal and State powers over accounting and depreciation.

The intent of Congress to protect intrastate ratemaking authority is confirmed by almost 50 years of administrative practice. In implementing Section 220 of the Act, the FCC officially acknowledged and approved the practice of maintaining separate records for intrastate accounting and ratemaking.[146] Prior to the issuance of the *Preemption Decision*, the FCC had consistently acknowledged that its accounting provisions were not binding on the States for ratemaking.[147] The same conclusion

[146]*Accounting Rules for Telephone Companies*, 1 F.C.C. 45 (1935).

[147]*See supra* notes 107-10 and accompanying text.

was reached by State courts and agencies.[148] This history is strong evidence of Congressional intent, as this Court held in *BankAmerica Corp. v. United States.*[149]

This Court recognized that the failure of an agency to assert its authority is not determinative of the agency's lack of authority, but " 'failure to use such a power for a long time indicates to us that the commission did not believe the power existed.' "[150] When this non-exercise of power was combined with a consistent interpretation by informed agencies over an extended span that the power did not exist, the interpretation was given "powerful weight."[151]

The legislative history of the Federal-State Communications Joint Board Act, passed in 1971, shows that Congress was well aware of the historic development of dual regulation and the use of the separations process to define the limits of Federal and State ratemaking authority. The Senate Report on the Act states: "[F]or each jurisdiction effectively to exercise its authority, procedures are needed to apportion the costs for services under each jurisdiction."[152] Congress knew that the States prescribed ratemaking practices for plant allocated to intrastate jurisdictions. It implicity approved the continuation of this practice.

148See *supra* notes 111-14 and accompanying text.

149103 S.Ct. 2266 (1983).

150*Id.* at 2272, quoting *Federal Power Com'n v. Panhandle Eastern Pipe Line Co.*, 337 U.S. 498, 513 (1949).

151103 S.Ct. 2272.

152S. Rep. No. 92-632, 92d Cong., 1st Sess., *reprinted in* 1971 U.S. Code Cong. & Ad. News 1511 at 1512.

The legislative history of the Communications Act, including Section 220, confirms the intent to preserve State ratemaking authority. Congress recognized that the States would require records for intrastate ratemaking and declined to withhold that authority. It reserved to itself — not to the FCC — the power to legislate further in the area. Fifty years of administrative history establish that the FCC never believed it could set intrastate rates. Therefore, the *Preemption Decision* conflicts with Congressional intent.

C. The Alleged Conflict Between the FCC Policy and State Law Does Not Justify the Evisceration of Statutory Limits on FCC Jurisdiction.

The FCC and the court of appeals referred to a conflict between the Federal policy and State laws and practices to justify the *Preemption Decision.*[153]In this respect, they misapplied the preemption analysis embodied in *de la Cuesta.* In that case, this Court analyzed whether a *valid* federal regulation could coexist with State provisions and, finding a conflict, invalidated the State practices.[154] A conflict analysis is not relevant, however, when Congress explicitly sanctions the exercise of State power.[154] In this case, the actual "conflict" is between an FCC policy and explicit limits contained in the Communications Act. The only conceivable rationale for reading out these limiting provisions would be the *impossibility* of reconciling *statutory* provisions.

153*Preemption Decision,* 92 F.C.C.2d at 877, J.S. App. at A-95 - A-96; *Virginia State Corp. Com'n v. F.C.C.*, 737 F.2d at 395, J.S. App. at A-14 - A-15.

154*Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta,* 458 U.S. 141, 155-60 (1982).

The impossibility of dual regulation is, indeed, the underlying basis for the few lower court decisions finding that FCC regulations preempted conflicting State provisions. These rulings arose in circumstances not anticipated by Congress. The courts in these cases were faced with the task of reconciling Sections 152(a) and (b), which divide Federal and State regulatory authority. As the courts recognized, circumstances exist where this division is physically impossible. In these cases, either the FCC or the States must have exclusive authority. In each case, the courts determined that preemption was necessary because the continued existence of the intrastate regulations would curb the affirmative power of the FCC over interstate communications.

For instance, in *North Carolina Utilities Com'n v. F.C.C. ("NCUC")*,[156] the Federal and State tariffs contained conflicting provisions for the *physical* interconnection of jointly used equipment. Since the equipment could not be separated in the physical sense, reconciliation of the competing regulations was impossible. Similarly, in *Computer and Comm. Ind. Ass'n v. F.C.C.*,[157] the State laws and Federal regulations conflicted as to whether certain types of equipment could be regulated at all. The equipment could not be broken into its interstate and intrastate components, so the court approved preemption.

In contrast to the line of cases arising from *NCUC*, it is possible to accommodate the statutory provisions in this case. There is no conflict between the provisions allocating authority over the subject matter. Federal and

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[156]537 F.2d 787 (4th Cir. 1976), *cert. denied*, 429 U.S. 1027 (1976).

[157]693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983).

State ratemaking responsibilities have been divided for decades through the separations process — a procedure mandated by this Court in *Smith v. Illinois Bell Tel. Co.*[158] and expressly sanctioned by Congress.[159] The court of appeals conceded that differing Federal and State accounting and ratemaking policies can coexist.[160] By intruding into the realm of intrastate ratemaking and requiring rate changes for plant allocated to the State jurisdiction, the FCC crossed a dividing line established by Congress.

Even if the FCC could overrule the division of authority in the Act by creating a new policy that conflicts with State law, it failed to demonstrate how its policy in this case will be furthered by the *Preemption Decision*. The asserted connection between the capital recovery of regulated, monopoly companies — which generally do not engage in competition — and effective competition in the telecommunications market place has never been established by the FCC and has no apparent logical basis. A mere eight months before the issuance of the *Preemption Decision*, the FCC had issued a well-reasoned analysis of the historical compatibility of simultaneous State and Federal regulation of the telephone industry. It concluded that there was no necessity to preempt.[161] Little weight should be given to the FCC's finding of a conflict in light of its abrupt reversal of position at the urging of regulated companies.

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[158]282 U.S. 133 (1930).

[159]47 U.S.C. §§221(c), 410(c).

[160]737 F. 2d at 395, J.S. App. at A-15.

[161]*Amend. of Part 31*, 89 F.C.C.2d 1094 (1982), J.S. App. at A-61.

The decision of the court of appeals approves an attempt to rewrite the Communications Act. Moreover, the "purpose" analysis of the court of appeals is especially objectionable because it gives the FCC license to ignore all statutory limits to its authority over intrastate communication. If the FCC can preempt here under the aegis of Section 151, despite the specific reservation of State authority, then all ratemaking matters are open to FCC usurpation, as long as the issue arguably may foster the goals stated in Section 151.[162] But the FCC is bound by limits prescribed by Congress. As the court of appeals for the District of Columbia Circuit recently stated in a slightly different context, "we are not at liberty to release the agency from the tie that binds it to the text Congress enacted."[163] No matter how strongly the FCC desires to preempt State jurisdiction, Congress has not given it that authority and the FCC cannot assert what it does not have.

II. THIS COURT HAS APPELLATE JURISDICTION OF THE APPEAL PURSUANT TO 28 U.S.C. §1254(2).

This Court has jurisdiction over the decision of the court of appeals pursuant to 28 U.S.C. §1254(2), which permits appeals to this Court when State laws are invalidated as repugnant to the United States Constitution. The decision of the court of appeals affirmed a ruling that invalidates State ratemaking orders. The *Preemption Decision* has been interpreted in a Federal court enforcement proceeding as expressly invalidating ratemaking orders of the Louisiana Commission. The Federal court interpreted the decision as a "direct order . . . specifically declaring

[162]737 F.2d at 398, J.S. App. at A-21 (Widener, J., dissenting).

[163]*M.C.I. Telecomm. Corp. v. F.C.C.*, No. 85-1030 (D.C. Cir., July 9, 1985) at 4.

that inconsistent State prescribed depreciation rates are void."[164] The enforcement decision invalidated the State ratemaking orders on a constitutional ground: that they were preempted.[165]

Ratemaking orders of a legislative nature are State "statute[s]" for the purpose of 28 U.S.C. §1254(2).[166] Article 4, Section 21 of the Louisiana Constitution invests the Louisiana Commission with general regulatory authority over common carriers and public utilities. The ratemaking function of the Louisiana Commission is legislative.[167]

The *Preemption Decision* invalidates State laws on constitutional grounds. Congress intended that this Court have appellate jurisdiction to ensure that State laws are not deemed unconstitutional without review by the highest Federal court. Therefore, the Court has jurisdiction over the appeal of the Louisiana Commission. Alternatively, the Court should treat the appeal papers as a petition for certiorari pursuant to 28 U.S.C. §2103.

[164]*South Cent. Bell Tel. Co. v. Louisiana Public Serv. Com'n*, 570 F. Supp. 227, 236 (M.D.La. 1983), *aff'd* 744 F.2d 1107 (5th Cir. 1984).

[165]570 F.Supp. at 231-32; 744 F.2d at 1121.

[166]*E.g., Atchinson T. & S. F. Ry Co. v. Public Util. Com'n*, 346 U.S. 346, 348 (1953); *Lake Erie & Western R. Co. v. State Public Util. Com'n*, 249 U.S. 422, 424 (1919).

[167]*E.g., Gulf States Util. Co. v. Louisiana Pub. Serv. Com'n*, 364 So. 2d 1266, 1268 (La. 1978); *South Central Bell Tel. Co. v. Louisiana Pub. Serv. Com'n*, 352 So.2d 964, 969, (La. 1977), *cert. denied*, 437 U.S. 911 (1978).

CONCLUSION

The conscription of State regulatory officials to further a Federal policy by increasing intrastate telephone rates is unjustified. The *Preemption Decision* defies the express reservation of intrastate jurisdiction in the Communications Act, cuts deeply into the sovereignty of the States, and overturns more than five decades of regulatory precedent and practice. The preemption of State ratemaking practices is unnecessary because interstate and intrastate ratemaking functions are separable, and indeed have been separated for decades. Therefore, the Court should reverse the decision of the court of appeals, overturn the *Preemption Decision*, and reaffirm the autonomy of the States in setting intrastate telephone rates.

Respectfully submitted,

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JOINT APPENDIX

(15) (15) (13) (13)

Nos. 84-871, 84-889, 84-1054, and 84-1069

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

LOUISIANA PUBLIC SERVICE COMMISSION, APPELLANT
vs.
FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA

CALIFORNIA AND PUBLIC UTILITIES COMMISSION
OF CALIFORNIA, ET AL., PETITIONERS
vs.
FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA

PUBLIC UTILITIES COMMISSION OF OHIO,
ET AL., PETITIONERS
vs.
FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA

FLORIDA PUBLIC SERVICE COMMISSION, PETITIONER
vs.
FEDERAL COMMUNICATIONS COMMISSION AND
UNITED STATES OF AMERICA

**On Appeal and On Writs of Certiorari to the
United States Court of Appeals
for the Fourth Circuit**

JOINT APPENDIX

Notice of Appeal in No. 84-871 Filed November 27, 1984; Petitions For a Writ of Certiorari in Nos. 84-889, 84-1054, and 84-1069 Filed on December 10, 1984, January 10, 1985, and January 10, 1985, Respectively.

Certiorari Granted June 24, 1985.

(Continued on Inside Front Cover)

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RELEVANT DOCKET ENTRIES

FCC Docket Entries

In re Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies.

Date	FILINGS-PROCEEDINGS
1979	
Aug 10	NOTICE OF PROPOSED RULEMAKING adopted directing that interested persons may file comments on or before 10-9-79 and reply comments 11-12-79; and an original and 5 copies of all statements or briefs shall be furnished to the Comm. (FCC 79-263).
1980	
Nov 6	FIRST R&O adopted directing that Part 31, is amended as set forth in the Appendix attached thereto, to be effective Oct 1 81, provided, however, any company desiring to, may make such accounting changes retroactive to an earlier date in calendar year 1981; & the Sec'y. shall cause a copy of this R&O to be published in the Federal Register. (Chairman Ferris not participating; Commr. Lee dissenting & issuing a statement; Commr. Fogarty issuing a separate statement). (FCC 81-104). Released: Mar 31 81. 5-18-81—ERRATA released.
1981	
Apr 30	Petn. for Clarification of the Comm.'s Nov 6 80 First R&O filed for Nat'l. Assn. of Regulatory Utility Commrs.
Apr 30	Petn. for Recons. of the Comm.'s Nov 6 80 First R&O filed for the People of the State of California & the Public Utilities Comm. of the State of California.
Jun 11	Opposn. to the Apr 30 81 Petn. for Recons. & Petn. for Clarification filed for AT&T.
Jun 11	Opposn. to the Apr 30 81 Petn. for Recons. & Petn. for Clarification filed for GTE Service Corp.

Date	FILINGS-PROCEEDINGS
1982	
Apr 1	MO&O adopted GRANTING to the extent reflected therein Nat'l. Assn. of Regulatory Utility Commrs.' Apr 30 81 petn. for clarification; DISMISSING AS MOOT People of the State of California's Apr 30 81 petn. for recons.; the Sec'y. of the FCC shall cause this MO&O to be published in the Federal Register & in the Federal Communications Reports; & the Sec'y. shall cause to be served on each party of record in this proc. & each state comm. having jurisdiction over intrastate communication service a copy of this MO&O. (Commrs. Fogarty & Jones dissenting & issuing a joint statement) (FCC 82-155). Released: Apr 27 82. Apr 30 82—ERRATUM released to include Commr. Rivera dissenting after the phrase "By the Comm.". (3803).
Jun 7	Petn. for Recons. of the Comm.'s Apr 1 82. Dec 22 82 GRANTED (MO&O) MO&O filed for AT&T.
Jun 7	Petn. for Declaratory Ruling for General Telephone.
Jun 8	Joint Petn. for Clarification of the Comm.'s Apr 1 82 MO&O filed for GTE Service Corp., Continental Telecom, Inc. & United Telephone System, Inc.
Jul 2	Petn. for Review of the Comm.'s Apr 1 82 MO&O filed in the U.S. Court of Appeals for the District of Columbia Circuit by Richard McKenna & James R. Hobson, Attys. for GTE Service Corp. (Case No. 82-1747).
Jul 6	Petn. for Review of the Comm.'s Nov 6 80 First R&O & Apr 1 82 MO&O filed in the U.S. Court of Appeals for the District of Columbia Circuit by Raymond Scully, Lester G. Stiel, Michael Boudin & Leonard R. Stein, Attys. for AT&T. (Case No. 82-1752).
Jul 13	Opposn. to General Telephone's Petn. for Declaratory Ruling & Motn. to Dismiss the same filed for Office of Consumer's Counsel, State of Ohio.
Jul 14	Opposn. to AT&T's Jun 7 82 petn. for recons. filed for Nat'l. Assn. of Regulatory Utility Commrs.

Date	FILINGS-PROCEEDINGS
Jul 14	Response to AT&T's Jun 7 82 petn. for recons. filed for People of the State of California & the Public Utilities Comm. of the State of California.
Dec 22	MO&O adopted GRANTING AT&T's Jun 7 82 petn. for recons.; GRANTING General Telephone Co. of Ohio's Jun 7 82 petn. for declaratory ruling (petn. was filed with the Bureau) to the extent reflected therein; the Sec'y. shall cause this order to be published in the Federal Register; & the Sec'y. shall cause a copy of this order to be served on each state commission. (Commr. Fogarty issuing a separate statement). (FCC 82-581). Released: Jan 6 83.
Feb 11	Petn. to Review the Comm.'s Dec 22 82 MO&O filed in the U.S. Court of Appeals for the 4th Circuit by Donald G. Owens, Deputy Gen. Counsel, Russell W. Cunningham, Associate Gen. Counsel & Sherry H. Bridewell, Atty. for Virginia State Corp. Commission. (Case No. 83-1136).

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 83-1136

Virginia State Corp. Comm'r v. FCC

Date	FILINGS-PROCEEDINGS
1984	
Jun 18	ORDER upholding FCC Order, In re Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Cos., 92 F.C.C. 2d 864 (1983).
Oct 3	ORDER denying the petitions for rehearing and suggestions for rehearing in banc.

FCC 80-650

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D. C. 20554

Docket No. 20188

In the Matter of

Amendment of Part 31 (Uniform System of Accounts for Class A and Class B Telephone Companies) so as to permit depreciable property to be placed in groups comprised of units with expected equal life for depreciation under the straight-line method.

REPORT AND ORDER

(Adopted: November 6, 1980; Released: December 5, 1980)

BY THE COMMISSION:

I. Introduction

1. The American Telephone and Telegraph Company and the associated Bell System operating telephone companies (hereinafter AT&T or Bell) filed a petition on September 23, 1973 requesting that the Commission amend Part 31 of its Rules and Regulations (Uniform System of Accounts for Class A and Class B Telephone Companies) to permit property to be placed in subgroups comprised of units expected to have the same life for depreciation accrual rate development purposes. In essecnce, AT&T requested that the Commission amend Part 31 to allow the use of the straight-line equal life group (SLELG) procedure of depreciation rate development for property (except station connections) placed in service after December 31, 1974. The equal life group procedure is also known as the unit summation procedure. Currently, telephone companies are allowed to use only the straight-line group procedure of depreciation rate development as defined in Part 31 with the practice having been to determine depreciation rates by using the straight-line vintage group (SLVG) procedure.

2. The basic reason given by AT&T for proposing SLELG is that such a method would provide for the recovery of capital more nearly in line with its consumption as measured by the physical retirement of property. Under the SLVG method, depreciation is accrued on a class or subclass of depreciable plant on the basis of the average service life of each vintage group. According to AT&T, a reserve deficiency results at the time of retirement in the case of plant retired before an age equal to the average service life of the vintage group. This reserve deficiency is later made up by accruals on units that live beyond the average service life of the group. Under the SLELG method, depreciation is accrued upon those units of property in a vintage group that are expected to have the same service life so that, if projections are accurate, no reserve deficiency results since each unit is fully depreciated in the accounts at the time of retirement. The use of the SLELG method results in a higher accrual rate during the earlier years of the total property service life and a lower rate in later years.

3. In its petition, AT&T stressed the importance of the proposed change on the maintenance of the financial integrity of the Bell System companies. It alleged that, because the SLVG method now being used fails to match the capital recovery with the rate of capital consumption, the companies are failing to generate funds as rapidly as they should. Thus, AT&T asserted, the companies are faced with going to the outside capital markets for replacement of plant retired at an earlier date than the average service life when such funds should be internally generated through appropriate depreciation procedures. Bell claims that the proposed SLELG method will more closely match capital recovery with capital consumption and thus will provide an amount of internal cash flow which will more nearly match replacement construction requirements. AT&T proposed that the changeover from SLVG to SLELG be phased in over a five-year period to minimize the impact on depreciation rates, accruals, and revenue requirements.

4. In addition to AT&T's proposal to permit a change from the SLVG method to the SLELG method of depreciation, the Commission also is considering issues relating to the impact of

the proposal on all parties concerned and on the most effective way to implement the proposal.

II. History of the Proceeding

5. Following the receipt of AT&T's petition for rulemaking, the Commission, on October 10, 1973, issued a public notice asking for comments within thirty days on AT&T's proposal. Nineteen parties[1] filed initial comments, some of which were not timely and some of which were not served on AT&T. While some of these comments touched on the merits of AT&T's proposal, the bulk were concerned with procedural matters, such as, that time should be allowed to study the proposal or that hearings should be held on the subject. AT&T filed reply comments urging that the Commission proceed with the issuance of a Notice of Proposed Rulemaking (NPRM) at the earliest opportunity.

6. The Commission released a NPRM on September 19, 1974, establishing Docket No. 20188 and inviting comments and reply comments from all interested parties on AT&T's petition. After granting several requests for extensions of time, the Commission set March 24, 1975, as the date for filing comments and May 26, 1975, as the date for filing reply comments. In addition to the Bell System, eighteen parties filed comments in response to the Commission's notice and five parties filed reply comments. These parties are identified and their comments discussed Section VII, below.

7. In June 1976, the Commission awarded a contract to Ernst & Ernst, Inc., (Ernst), an independent accounting firm, to conduct a study of various aspects of depreciation. Ernst completed the study, entitled "Study of Depreciation Rate Practices and Policies," in July, 1977. Among the issues studied by Ernst were

[1] The parties, including those whose comments were not timely and/or were not served on AT&T are GTE Service Corporation, Rochester Telephone Corporation, Arthur Andersen & Co., Arthur Young & Company, Coopers & Lybrand, Department of Defense, and the following state public service commissions: Alabama, Arizona, California, Illinois, Kentucky, Maryland, Michigan, Mississippi, New York, North Carolina, Ohio, Tennessee and Wisconsin.

the use of Equal Life Group Depreciation in general and the Docket No. 20188 proposal in particular. Following the completion of the study, the Commission issued a public notice seeking comments on the Ernst report. Thirteen parties, including the petitioner, filed comments, which are discussed in Section VII, below.

8. On March 22, 1978, GTE Service Corporation submitted a request to the Secretary of the Commission, together with a copy of the January 13, 1978, Canadian Radio-television and Telecommunications Commission's (CRTC) Decision in Phase I of the Inquiry into Telecommunications Carriers' Costing and Accounting Procedures (Cost Inquiry), which was initiated in 1972 by the Canadian Transport Commission. As the CRTC proceeding had been extensively covered in the Ernst report, GTE asked that the decision in that proceeding be included in the record of Docket 20188. That particular decision dealt specifically with the appropriateness of the ELG procedure and how it should be implemented by Canadian companies.

9. On February 25, 1980, the Chief, Accounting and Audits Division of the Common Carrier Bureau requested that AT&T and GTE provide revenue requirement impact studies for their respective domestic telephone systems based upon alternative accounting assumptions. The studies were received and served on all parties of record in this proceeding during March 1980. The Common Carrier Bureau announced in a Public Notice on March 31, 1980, the receipt of the revenue requirement impact studies and that any party(ies) wishing to comment on the impact studies could do so by May 1, 1980. Three responses were received on these revenue requirement impact studies, from the State of Wisconsin Public Service Commission, the New York Public Service Commission, and the Department of Defense on behalf of all Federal Executive Agencies.

III. The Role and Purpose of Depreciation Accounting

10. In order to understand the purpose of depreciation accounting, we should first know the purpose of accounting in general and some of its basic tenets. Accounting, as developed

over the years, has had as its most basic purpose the goal of presenting a financial picture to investors and others that would portray the current condition of the venture; the results of management's stewardship of the investors' funds; the relative integrity of the enterprise; and, on an interim or periodic basis, the results of operations or progress of the business. One of the earliest concepts was that of matching costs and revenues. That concept attempts to relate costs to the period in which they occur and against the revenues generated for which those costs were incurred. It has been said that every expense is related directly or indirectly to the production of revenue. However, not every expenditure is appropriately charged to the accounting period in which it is incurred. Expenditures for some items are more properly charged to the various periods in which they are useful in the production of revenues. Expenditures for long-lived assets are of this nature and the matching principle requires a determination of how much of the cost should be charged to each succeeding period. This process has been called "depreciation accounting."

11. Frequently, there is substantial misunderstanding as to the degree of precision embodied in financial statements and reports. The National Association of Railroad and Utilities Commissioners (NARUC) in the 1943 "Report of Committee on Depreciation" (p, 33) said:

> Only after a plant asset has lived its useful life will the true depreciation cost be known. The same difficulty is encountered in computing the annual profit and loss of businesses. Only after a business has been wound up can the absolute profit and loss be determined, and then only for the entire period of its existence. Nevertheless it is necessary to make determinations of depreciation and profit and loss periodically, at least annually, and the fact that very precise answers cannot be obtained should be no deterrent. Reasonably accurate results in both cases are all that should be expected and these can usually be achieved.

12. Even earlier than 1943, a similar observation directly related to the measure of depreciation was made by Justice Brandeis in *United Railways & Electric Co. v. West,* 280 U.S. 234,

262, 50 S.Ct. 123, 74 L.Ed. 390, (1930), who acknowledged the lack of precision in the exercise when he said:

> . . . an annual depreciation charge is not a measure of the actual consumption of plant during the year. No such measure has yet been invented. There is no regularity in the development of depreciation. It does not proceed in accordance with any mathematical law. There is nothing in business experience, or in the training of experts, which enables men to say to what extent service life will be impaired by the operations of a single year, or of a series of years less than the service life . . . even where it is known that there has been some lessening of service life within the year, it is never possible to determine with accuracy what percentage of the unit's service life has, in fact, been so consumed. Nor is it essential to the aim of the charge that this fact should be known. The main purpose of the charge is that irrespective of the rate of depreciation there shall be produced, through annual contributions, by the end of the service life of the depreciable plant, an amount equal to the total net expense of its retirement.
>
> . . . It is a bookkeeping device introduced in the exercise of practical judgment to serve three purposes. It preserves the integrity of the investment. . . . It serves to distribute equitably throughout the several years of service life the only expense of plant retirement which is capable of reasonable ascertainment—the known cost less the estimated salvage value. And it enables those interested, through applying that plan of distribution to ascertain, as nearly as is possible, the actual financial results of the year's operation.

13. Recognition of the inability of individuals to achieve absolute precision in arriving at various accounting measures however, should not diminish the striving for such measures since a failure to attain reasonable measures can result in erroneous and misleading financial reports. Reliance on such erroneous information, in turn, can result in erroneous investment and regulatory decisions.

14. All accounting measures are important, but in the case of capital intensive industries the measure of depreciation becomes

even more important. On the whole such industries are frequently regulated and annual revenue requirements reflect both the current measure of the consumption of capital (depreciation) and a provision for the costs (return requirement) of the capital still unrecovered through depreciation charges. If depreciation policies or practices were to be determined solely with concern for the level of revenue requirements, the actual measure of depreciation might be misstated. Such distortion of the measure of depreciation would in turn lead to a misstatement of the results of operations for the period and would also misstate the relative position of the enterprise as shown by its balance sheet. If such distortions were perceived by present and potential investors and were deemed to be deleterious to the safety and recovery of their investment, they in turn would likely demand a higher return on their funds. Consequently, a failure to properly measure by understating these costs would, in the long run, probably be offset by higher costs of capital without any real avoidance of the ultimate need to provide full recovery for the capital. The importance of a proper measure of depreciation and the potential adverse effects of improper measures on investors were addressed in the NARUC "Reports of Committee on Depreciation for the Years 1943 and 1944," starting at page 128:

> Those consequences stem from the fact that depreciation expense is an operating cost commensurate with the consumption of service life of the utility plant. Accordingly, if the annual accrual for depreciation is understated, there is a corresponding overstatement or inflation of net income and earned surplus. Investors are given an illusory and false impression with regard to earnings coverage, the effects of which are twofold and cumulative.... Moreover, if past deficiencies in depreciation accruals were substantial, it may be necessary to make up the back accruals by an appropriate adjustment of existing or future earned surplus and, in extreme cases, of the capital account itself.

15. Measures of costs under depreciation accounting, as well as other forms of accounting, are of the utmost importance and should be as accurate as circumstances will allow. The accounting measures of costs and revenues are the information base upon

which pricing and ratemaking decisions are predicated. These same measures establish the amount of expenses that a regulated enterprise must have an opportunity to recover[.] Finally, it is the provision for depreciation that ultimately determines how much remains in the rate base and thus, how much in dollars must be provided to investors as a return on their remaining investment.

IV. Statutory Provisions

16. Recognizing the need for accurate accounting measures and records, including an accurate measure of annual depreciation charges within reasonable limits, the Communications Act of 1934 gave the Commission the authority to "... in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act..," These provisions are set forth in Section 220(a).

17. In Section 220(b), the Commission is required to "... as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property.... The Commission may, when it deems necessary, modify the classes and percentages so prescribed."

18. Paragraph (g) of Section 220 requires the Commission to give carriers "at least six months" notice before required accounting changes are to take effect.

19. Paragraph (i) of Section 220 requires the Commission to give state commissions having an interest a reasonable opportunity to present their views as to proposed changes in prescribed requirements.

V. Rules Implementing Section 220

20. The Commission's rules establishing overall accounting and the more specific depreciation accounting requirements are embodied in Parts 31, 33, 34, 35, and to some extent in Part 43. Parts 31 and 33 establish Uniform Systems of Accounts for Class A, B, and C Telephone Companies. Parts 34 and 35 establish

Uniform Systems of Accounts for Radiotelegraph Carriers and for Wire-Telegraph and Ocean-Cable Carriers, respectively. Part 43 establishes requirements for various reports of communication common carriers and certain affiliates. Part 43 derives its authority from Sections 211 and 219 of the Communications Act of 1934. It is of importance here that Section 43.43 sets forth requirements for reports of proposed changes in depreciation rates.

21. The essential provisions of Part 31 are of the most importance at this time as they cover all of the subject telephone companies for whom we presently prescribed depreciation rates. The only other carriers for which the Commission has recently prescribed depreciation rates are Western Union Telegraph Co. (WU), which is subject to Part 35 of the Commission's rules, and ITT World Communications, Inc., which is subject to Part 34 of the Commission's rules.

22. The portions of Part 31 that are of the most immediate significance in terms of defining or estalishing depreciation accounting requirements are: Section 31.01-3, Definitions; Section 31.02-80, Computation of depreciation rates; Section 31.02-81, Depreciation charges; Section 31.02-82, Classes of depreciable telephone plant; and Section 31.02-83, Plant retired for causes not factors in depreciation. Other sections of Part 31 set forth requirements and definitions of specific accounts such as the balance sheet accounts for telephone plant in service; extraordinary maintenance and retirements; and depreciation reserve. In the operating expense accounts, similar provisions are made for the depreciation and the extraordinary retirements expense accounts.

23. Under the definitions portions of Parts 31, 34 and 35 the significant differences are as follows:

Part 31 includes a definition of group plan—which does not appear in Parts 34 and 35.

Sec. 31.01-3 Definitions.

(q) "Group plan," as applied to depreciation accounting, means the plan under which depreciation charges are accrued upon the basis of the original cost of all property included in each depreciable plant account, using the average service life thereof properly weighted, and upon the retirement of any depreciable property its full service value is charged to the depreciation reserve whether or not the particular item has attained the average service life.

Parts 34 and 35 include defintions of "Net book cost" and "Subclass" which do not appear in Part 31.

Sec. 34.02-1 Restrictive use of certain terms. "Net book cost," as applied to a specific portion of plant, means the "book cost" of that portion minus that part of the related depreciation (or amortization) allowance account that is assignable to that portion of the plant.

"Subclass,"as applied to depreciable plant, means that portion of a "class" of plant, preferably corresponding to one or more "subprimary" plant accounts, to the cost of which a specific percentage rate of depreciation is applied in accounting for "depreciation," which percentage rate differs from those that are applied with respect to other "subclasses" of the same "class" of such plant.

24. Rules regarding treatment of retirements of plant for causes that were not factors in the computation of depreciation (extraordinary retirements) are essentially identical for Parts 31, 34 and 35.

25. The rules for the computation of depreciation rates are essentially identical except that Part 31 includes a sentence as follows:

These percentage rates shall be computed in conformity with the group plan of accounting for depreciation. . . .

26. Part 31 also includes some specific reference to removal costs of station apparatus and its accounting in the station connections account. This portion is unique to the telephone companies and would not be applicable to the other types of carriers.

27. Parts 34 and 35 under the instructions for the computation of depreciation rates, as previously stated, are essentially

identical to Part 31, with the exceptions noted above, and in addition have one other very significant difference. Both Parts 34 and 35 include language specifically addressing the calculation of and use of "remaining-life rates." The language in Section 34.04-2, Computation of depreciation rates, says:

> (c) . . . However, a carrier, upon receiving prior approval from the Commission or, upon prescription by the Commission, shall apply such depreciation rate as will amortize the difference between the net book cost of a class or subclass of plant and its estimated net-salvage value during the known or estimated remaining service life of that plant. Any carrier which, at the effective date of this rule, is applying the remaining-life method of depreciation accounting may continue to do so unless otherwise directed by the Commission.

28. This last item regarding remaining-life depreciation will be addressed further in a discussion of reconciliation of differences in the Commission's rules. Paragraph 12 of the NPRM addressed the question of whether conformity, by like amendments, should be sought in the Commission's rules.

29. A common thread throughout the Commission's rules for depreciation accounting has been that its purpose is to allocate through annual charges to expense the service value of the property over its service life in accordance with the straight-line concept. The Commission defines "service value" as the difference between original cost and net-salvage value, and "service life" as the period of time between installation and retirement of plant. The Commission's definition of the straight-line concept as stated in Part 31, Section 31.01-3, Definition is:

> (gg) "Straight-line method," as applied to depreciation accounting, means the plan under which the service value of property is charged to operating expenses and to clearing accounts and credited to the depreciation reserve through equal annual charges as nearly as may be during its service life,

30. The Commission's requirement that depreciation charges follow the straight-line concept is one that is well recognized by other regulatory bodies and more importantly enjoys widespread

use and recognition by businesses in general. The comments of the Committee on Depreciation of NARUC in its 1943 report (page 89) are of interest:

> Widespread Use of Straight-line Method
>
> It is significant that the straight-line method is in almost universal use. This does not prove it to be the best method. Nevertheless, when business managements throughout the country, free to adopt any reasonable method, have used the straight-line method, such general acceptance of the method is entitled to great weight in considering its merits.

31. In 1975 the Technical Research Division of the American Institute of Certified Public Accountants found that the straight-line pattern for allocating depreciation charges was still the overwhelming choice among businesses in general.

VI. The Investors' and the Consumers' Interest in the Cost and Recovery of Capital

32. In considering this matter it is important to recognize some fundamental concepts that have been recognized by both the courts and practical observers in business, finance and academia.

33. As observed by the U.S. District Court in *Goelet v. United States*, 161 F.Supp. 305 (S.D.N.Y. 1958), the purpose of depreciation is to make provision for recovery or charge of the original cost of the property by the end of its life. It is noteworthy that the court did not say more, nor did it say less. The comments of Justice Brandeis in *United Railways & Electric Co. v. West, supra,* also considered the purpose of the charge.

34. Forty-three years later in the course of its review of another case involving depreciation recovery, the United States Court of Appeals, District of Columbia Circuit, enunciated the same principle of investor recovery of the whole cost of investment and the attendant interim inaccuracies of the process in *Democratic Central Committee of the District of Columbia et al., Petitioners v. Washington Metropolitan Area Transit Commission, Respondent,* 485 F. 2d 786 (1973) where it said:

Computations of the cost of ordinary depreciation—normal physical deterioration—are made on the basis of estimates of service life and salvage value, and charges therefor are usually spread over the service period. Depletion allowances are similarly based on estimates of productive life, and usually are similarly spread. Even obsolescence may sometimes be foreseen and calculated in much the same manner. It is evident that if all predictions are accurate and the asset remains in service for precisely the period anticipated, the process will eventually yield to investors the exact amount of their investment, and will ultimately cost consumers the same amount. Consumers will thus absorb the investment loss and investors will be made whole.

But calculations, even of the highest predictive quality, sometimes go awry. Service life, productive life or salvage value may turn out to be more or less than originally estimated. Obsolescence may be slower or faster than expected in the beginning, or may arrive suddenly, and damage to or destruction of the asset may occur just as suddenly. In most instances, however, the consumers' financial obligation remains intact, the investors' right to recoupment remains unimpaired, and appropriate adjustments must be made. This is so although in terms of original expectations, the loss of serviceability is premature. Consumers bear the risk of that loss unless investors have been compensated for assuming it; if, as is more usual, investors have not, return of their investment is fully assured.

In this milieu, the distribution of the risks and burdens on utility assets is apparent. Consumers must ordinarily bear the expense of normal maintenance and, according to some decisions, of deferred maintenance as well. Beyond that, consumers must usually absorb the investment losses wrought by normal wear and tear on depreciable assets, and by exhaustion of depletable assets. *Even when an asset is underdepreciated at the time it is retired from service, consumers must reimburse the investors therefor. And when utility property becomes unsuitable by reason of obsolescence before investors have fully recouped their investment in it, the loss is passed on the consumers.* (Emphasis added; footnotes omitted)

35. Those same principles were acknowledged by this Commission in its Phase II Final Decision and Order in Docket 19129 at paragraph 172 where it cited the above court decision and said:

> We believe that these principles apply with equal force to capital gains on the disposition of AT&T's retired plant (which was once in the rate base) and that, under these principles, the gains in question here should benefit the ratepayer. By the same token, the ratepayers bear the risk of loss from sale below current book value of the property.

36. In the next paragraph of that order the Commission went on to say:

> We turn first to the case of depreciable property where we believe the fact that the users bear the risk of loss may be most clearly seen. *It is settled law that AT&T's stockholders are entitled to the opportunity to earn a fair return on the amount of capital they have prudently invested in the regulated enterprise.* See *F.P.C. v. Hope Natural Gas Co., supra,* at 603, *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission,* 262 U.S. 276, 289-90 (concurring opinion of Brandeis, J.) (1923). In practice, this translates to a return on the original (or depreciated book) value of AT&T's assets used and useful in providing telecommunications service. *Depreciation, in turn, is calculated on the original cost of AT&T's plant and is designed to regain over the service life of the asset the entire amount the investors paid to purchase it.* The money necessary to repay the investors, of course, comes from the users of AT&T services. Thus the ratepayers bear the risk both in terms of the return they pay the investors for the use of their capital and in the reimbursement of the investors for the decline in value (depreciation) of the assets used to provide service. To make this clear, we note that AT&T's method of depreciation, the Straight-Line Vintage Group method, see *supra* n. 90, does not recognize gains or losses. Under group depreciation, individual items of plant are grouped with similar types of

plant and the depreciation is calculated on the projected average life of the group. If an item within a group is destroyed, becomes technically obsolete, or otherwise is rendered unfit for service ahead of the projected date and is thus prematurely removed from service, the ratepayer reimburses AT&T for the loss of that asset because AT&T merely reduces the asset account and the depreciation reserve by equivalent amounts. Depreciation, and return, are then calculated from year to year as if they were still in the rate base until the investors have recovered the full purchase price plus return on their investment. This method of depreciation is prescribed for AT&T's use and is fully in accord with regulatory theory. It has the benefit, in an ongoing enterprise such as AT&T, of spreading losses over a reasonable period so as to minimize the impact on the ratepayers of catastrophic losses in any one year (if they are not covered by insurance). Still, this does not change the fact that the ratepayers bear the risk of loss in value. Thus, when such a piece of property is retired and disposed of and a gain results, the equities of the situation would suggest that the ratepayer should receive the benefit of that gain. Further, it is reasonable that the gain should be measured from the current book value of the property, original cost less depreciation and that it should be reflected as operating revenue. (Emphasis added)

VII. Evaluation of the ELG Proposal
A. Positions of the Parties

37. The parties filing comments in this proceeding, in addition to the Bell System, generally can be grouped into three categories—the independent telephone industry, along with Western Union Telegraph Co. (WU); the accounting profession; and the state regulatory commissions and associations representing these commissions. The basic positions of these groups, and the positions of the various individual parties making up the groups, are discussed below.

38. The Bell System, obviously, urges the Commission to adopt the ELG method of depreciation. In its comments, AT&T

repeats its earlier position put forth in its petition, and discussed in the "Introduction" to this order. Essentially, Bell stresses the importance of matching capital recovery with capital consumption, which will provide more internally generated funds to meet replacement construction requirements. Also, AT&T underlines the importance of the proposed change in depreciation practices on the maintenance of the financial integrity of the Bell System companies.

39. The independent telephone industry (comments were filed by General Telephone and Electronics, United Telephone Co., Continental Telephone Co., and the United States Independent Telephone Association) and WU favor the adoption of the ELG method of depreciation, but with certain qualifications. For example, while General Telephone and Electronics (GTE) supports the use of ELG, it recommends applying the method to all new property at one time, rather than using a gradual "phase-in" approach as desired by AT&T. In addition, GTE suggests the use of "capital recovery schedules" which would set an advance determination of capital use and recovery, and then have the company accountable for the achievement of the schedule. The United Telephone Company (United) favors the use of ELG, and recommends that all telephone companies simultaneously phase-in property under that method. United also recommends that companies be allowed to use simulated data in using ELG because of the complexities involved in some cases in the use of actual data. Continental Telephone Company (Continental) also favors the use of ELG, but is concerned about the difficulty of attempting to follow AT&T's complex methodology. Therefore, Continental requests that the methodology used by AT&T not be made mandatory. The United States Independent Telephone Association (USITA) favors the adoption of ELG, but states that its use should be elective and should be as flexible as possible. WU does not object to the adoption of ELG, but does not want to use it.

40. Two accounting firms and the American Institute of Certified Public Accountants (AICPA) filed comments in response to the NPRM in this proceeding. The firm of Coopers & Lybrand endorsed the use of ELG, but commented that the use of

that method depended to a great degree on the availability of data. While the Bell System would have the necessary data to use ELG, Coopers & Lybrand believes, it is questionable whether small firms would have that data. The firm of Arthur Andersen and Company recommended that the Commission adopt the use of ELG, and encouraged other commissions to follow the FCC. Finally, the AICPA endorsed the use of ELG, given the availability of adequate data, as it should result in a more accurate matching of capital recovery with capital consumption which seems to be implicit in the Commission's rules.

41. Seven state regulatory commissions (California PUC, Colorado PUC, Florida PSC, Kentucky PSC, Maryland PSC, New York PSC, and Wisconsin PSC), plus the NARUC Subcommittee of Staff Experts on Accounting, the Southeastern Association of Regulatory Utility Commissioners (SEARUC), and the Department of Defense filed comments in response to the NPRM. All of these parties opposed the adoption of ELG, for a variety of reasons. The principal reason given by the state commissions for opposing ELG was that its adoption would result in an increase in revenue requirements and consequently an increase in rates to subscribers at the same time that inflation was driving up the prices of other utilities such as electric and gas. Additionally, they argued that the adoption of ELG would result in an added burden, and thus an added cost, to the commissions attempting to administer the method (most of the state commissions commenting believed that the method would be too complex to cope with and that commissions would be unable to administer it); it would result in an added cost to companies utilizing the method; and it would result, effectively, in a domino effect leading to the approval of the use of ELG by other regulated utilities. The NARUC subcommittee expressed its concern about the burden of increased revenue requirements on the ratepayer, and added that if ELG is adopted by the FCC, its use should be made mandatory only for the large telephone companies and elective for others. The SEARUC and the Department of Defense both opposed the adoption of ELG at the time their comments were filed, and recommended that hearings be held on the matter. Other arguments contended that the use of ELG would lead to higher income taxes, thus a greater burden on

ratepayers; that ELG was not a proper group method within the definitions of the Commission, and that there was no demonstrated need for increased cash flows for the industry.

42. Reply comments were submitted by six parties in this proceeding—AT&T, GTE, the Wisconsin PSC, the California PUC, the New York PSC, and the Department of Defense. Essentially, these replies reiterated the positions of these parties expressed in their earlier comments. AT&T argued that while the immediate impact of the adoption of ELG is an increase in revenue requirements, and thus rates, a cross over point will be reached in the longer-run and rates will actually decline. Additionally, AT&T notes that although the method may be complex to administer, with the use of computers by commissions, much of the complexity would be eliminated. Bell also stresses, as it had in earlier comments, the importance of matching capital recovery and capital consumption. GTE emphasizes in its reply comments the superiority of ELG over VG because the recovery of capital coincides more closely with consumption of capital. The state commissions and the Department of Defense contend in their replies that ELG does not provide a better matching of capital consumption with capital recovery and that the adoption of ELG is, in essence, the granting of a rate increase. However, the NARUC Subcommittee of Staff Experts on Accounting did recognize that there was technical support for ELG.

43. The Ernst report, "Study of Depreciation Rate Practices and Policies," was completed in July, 1977. As mentioned earlier, the use of ELG depreciation in general, and Docket No. 20188 in particular, were among the issues considered in the study. Ernst concluded that ELG provided a better matching of capital consumption with capital recovery than VG. Moreover, the study found that the use of ELG would increase a company's internally generated funds compared to the VG method and that the use of ELG would provide more information to commissions about capital management by utilities. However, Ernst also pointed out that the use of ELG would result in increased revenue requirements initially, and possibly over the longer term, depending on growth rates, cost of capital and tax policies. Additionally, Ernst acknowledged that the use of ELG would result in an increased

regulatory burden and consequently, increased regulatory staffs. In its conclusions Ernst recommended that the Commission should adopt ELG on a flash-cut basis as all of the Commission's objectives would be better served by ELG than VG; that it be allowed in such a manner that it could be adopted by any company, large or small; that depreciation reserves be established by depreciable category and maintained on a continual basis; that the FCC explore possible refinements in depreciation practices; that implementation problems, such as salvage accounting and application of ELG by the Independents be resolved by the regulators and the carriers; and that the Commission should monitor the activity in the accounting community regarding other concepts of "cost" and depreciation. The last recommendation was directed toward inflation type measures of accounting data.

44. Ten parties commented on the Ernst report. These were AT&T, GTE, United Telephone Co., USITA, California PUC, Florida PSC, New York PSC, Wisconsin PSC, the NARUC subcommittee and the Department of Defense. Essentially, all of these parties repeated their earlier positions on Docket No. 20188. AT&T's lengthy comments were the only comments to address the study in depth, and those comments pertaining to Docket No. 20188 were much the same as the earlier comments and reply comments filed in the proceeding.

45. In March of 1978, GTE submitted a copy of a decision by the CRTC in Phase I of the Cost Inquiry, which GTE requested be placed in the record of this docket. The particular decision focused on the allowance of ELG as a depreciation method for telecommunications carriers, and did approve such use.

46. Finally, during 1980, upon request of the Chief, Accounting and Audits Division, Common Carrier Bureau, AT&T and GTE filed updated impact data with respect to the implementation of ELG with the Commission and upon all parties of record. Following these submissions comments were solicited by a public notice which was also directly served on all parties of record. Comments were filed by the New York and Wisconsin Public Service Commissions and by the Department of Defense. The commenting parties repeated their earlier comments.

B. Discussion of the Merits

47. We begin by acknowledging that the issues involved in this proceeding are complex and not readily characterized as "right" or "wrong." Where depreciation methods and procedures are concerned, reasonable judgment must often substitute for mathematical certainty. We also recognize that a Commission-endorsed depreciation policy must consider economic and other public policy points of view. As will be specified later, we are directing the staff to continue to analyze accounting and depreciation issues within this broader context.

48. With respect to the straight-line equal life group procedure, we find that its application on an optional basis will further the mandate of Section 1 of the Communications Act, "to make available, so far as possible, to all people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communications service with adequate facilities at reasonable charges. . . ." 47 U.S.C. §151. The primary attraction from an accounting perspective of SLELG is that it appears to calibrate more closely the flow of revenues with the recovery of capital. Communications is a large and growing component of our nation's economy. It offers bright prospects for improving our society's productivity. Technological trends suggest an increasingly dynamic environment for telecommunications, with innovation in equipment and services proceeding at a much more rapid pace than in the past.

49. If the public is to realize the benefits of advances in communications, it is necessary that accounting and depreciation rules not stifle innovation and inhibit the introduction of new technology. It is important that the companies, their customers, and their investors, as well as the regulators, all have an accurate and objective financial picture of the companies' operations and capital requirements. The seeming attraction of stretching out lives to hold down depreciation expenses may impose longer-term costs on our society that far outweigh the short-term advantages. Although our decision to permit SLELG (or, with prior approval or appropriate showing, other methods or procedures), is likely to result in an increase in the near term in revenue requirements, we believe that the relative size of the increment will be repaid many

times over in future years as the ability of regulated telephone companies to continue to provide "... rapid, efficient ... communication service with adequate facilities at reasonable charges is enhanced." The ultimate burden on different user groups of any future rate increases resulting from our decision depends on the particulars of future plant investment as well as on the jurisdictional separations of such investment and corresponding expenses. The latter is the subject of a recently established Federal-State Joint Board.[2] Moreover, our decision to phase in the implementation of ELG will ameliorate any revenue requirement impact and permit us to take further action in a timely manner if warranted.

50. The remainder of this section will explain in greater detail the basis of our decision. To begin, we note an interesting view expressed at the turn of the century:

> The Question of Depreciation is one upon which so many articles have been written and so many opinions expressed that there would not appear to be much more which could profitably be said on the subject.[3]

Nevertheless, the record in this docket and the professional literature on the subject since that date are voluminous. From a thorough examination of the record and a comprehensive survey of the literature, we believe we can draw the following conclusions.

51. First, given the uncertainties of life estimation and results from statistical theory, variance of errors in prediction is likely to be less for larger groups of investment than for individual elements or smaller groups. Since accuracy is desirable, group methods are to be preferred according to this criterion. This should not preclude the application of unit methods for specific circumstances at some future time if the circumstances so warrant. Our rules should be changed to acknowledge such a possibility.

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[2] *Notice of Proposed Rulemaking and Order Establishing a Joint Board,* FCC 80-339.

[3] *The Accountant,* August 8, 1903 as quoted in "Accounting for Depreciable Assets," Technical Research Division, American Institute of Certified Public Accountants, Inc., 1975, p. 1.

52. Second, as the amount to be depreciated consists of one known (original cost) and two unknowns (cost of removal and salvage), we think it better to insist on a more disaggregated measure of accumulated depreciation (depreciation reserve) for the original cost of property while permitting a more general aggregation of accumulated depreciation provisions for the cost of removal and salvage. Such provisions could be vintage level reserve records for original cost and category level reserves for removal and salvage. This is similar to the decision of the CRTC in the case of ELG decided January 13, 1978.

53. Third, as to the methods to be allowed, we can only take notice of the consistent and preponderant choice of straight-line allocation patterns used by both the majority of regulatory bodies and more importantly by the majority of businesses, especially those that are unfettered by regulation. This choice has been made repeatedly over the years. Its preferability is noted in the proceedings in Docket 14700 before the ICC from 1923 to 1926 and prior to that by its selection and application by AT&T, in the NARUC report in 1943, and again in the survey conducted by the AICPA Research Division in 1975. Given that consensus, this Commission reiterates its preference for the straight-line allocation method. However, as in all things predictive, circumstances in the future might warrant some other allocation method for specific categories of investment under specific circumstances. In the event that a carrier under the jurisdiction of this Commission should make a persuasive argument in support of application of some timing pattern other than straight-line, then the staff of this Commission will review the circumstances and make appropriate recommendation to the Commission as to whether depreciation rates calculated by a method to achieve an allocation of costs other than straight-line should be approved or denied. In short, our rules should be amended to indicate that straight-line is a preference only absent other persuasive proof.

54. Fourth, it is certain that we have entered the age of computers and that earlier objections to the unit summation or ELG methods, based on the added mathematical complexities,

are no longer of themselves a justifiable basis for denying companies having such data processing capacities the use of any given method. The calculations, though voluminous, are straight forward and readily programmable.[4]

55. Fifth, from the perspective of accounting, the unit summation or ELG procedure is a superior one. This opinion was expressed as early as 1932 by Robley Winfrey, a noted expert in depreciation methods and processes. His views are summarized in passages from the book referenced in footnote 4:

> The unit summation procedure when used with the straight-line depreciation method corresponds to the basic concept of straight-line depreciation as generally understood in relation to single units of property. The results, when this procedure is used, are systematic and consistent with respect to a unit, a vintage group, a plant account, and the total investment in a utility system. The unit summation procedure permits the accrual of depreciation on property while it is serving the customers and at the time such expenses are rationally allocable to those customers.
>
> The use of the unit summation procedure to apply the straight-line method results in a systematic and consistent method of depreciation, both from a year-to-year standpoint and from a unit, account and total plant standpoint. The manner in which the property is grouped should not affect the overall company accrual. The procedure provides a means for accruing the depreciable cost, no more or no less. It also results in an accrued amount directly related to the life of the existing property and in an amount consistent with good judgment when related to the age and life of a matured property.

Id, at pages 36, 38.

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[4] See Fitch, Wolf, and Bissinger, *The Estimation of Depreciation*, Center for Depreciation Studies, Western Michigan University, 1975, p. 38. Similar support was given by Robley Winfrey (co-author), *Engineering Valuation and Depreciation*, 1953, in a letter to Dr. Fitch which the authors reproduced at page 45 of their text.

56. Other parties expressed similar conclusions in the record (see e.g., Ernst report at p. 443, Comments of AICPA, dated March 24, 1975). However, comments filed by the Wisconsin, New York, California, and Maryland Commissions claim similar virtues for the currently used straight-line vintage group method. The principal contention of these commissions seems to be based on a definitional distinction and on a quote from a text by Winfrey. These arguments are sufficiently refuted by the Ernst report (at page 329) and by the statements of Winfrey (see paragraph 55).

57. Accordingly, this Commission accepts the recommendation of the staff based on analysis of the record and the literature that the unit summation or ELG method is acceptable, provided it is assured that adequate data is available for proper application of the method; that record keeping and reporting practices will enable monitoring of the reasonableness of the rate of allocation of both original cost and provisions for salvage and removal; that such allocation of original cost will achieve allocation over the service life of the property neither more nor less than 100% of the investment net of salvage value.

58. Sixth, comments have suggested that the unit summation or equal life group method does not enable or enhance determinations of salvage, removal, or life survivorship estimates. Of course it does not, for it is nothing more than an added step to the process that is presently being followed in the application of the vintage group method. It is, as its proponents state, nothing more than a mathematical process, going one step further than the present vintage group calculations. It has been precisely that further step and its requisite date handling requirements that has blocked prior usage of this method.

59. Seventh, argument has been made that the unit summation method or ELG is more sensitive than is the straight-line vintage group method to the shape of the estimated life curve which is applied to the particular property. This appears to mean that SLVG is more concerned with survivorship over the whole-life span than with the measurement of property survivorship within more limited interim periods. This may be true; however, it is the basic contention of the advocates of ELG that the primary

failure of the VG method is in relation to the allocation of costs for those properties which last only a few years in plant groupings that tend on average to live for a great number of years. It is to be presumed and expected that those studying the survivorship patterns, both company and commissions, will strive to select the most representative data, including its probabilities, for rate setting purposes. Again, this is not an exercise in precision, but it is a most reasonable attempt to measure, and re-measure as necessary, the consumption of capital of long lived investments.

60. Eighth, the petitioners have asserted that adoption of ELG will enhance cash flqws or internally generated funds, thus reducing the need for and demands upon outside capital resources. Those in opposition have contended that adoption will increase revenue requirements on consumers and will impose an added burden on regulatory commissions and smaller carriers. Further, opponents have contended that adoption might have a domino effect—forcing approval of similar methods for other utilities.

61. There is no doubt that any change which moves the recognition of costs from a decelerated or deferred mode to a more instant recognition will increase both revenue requirements and cash flow. The results are the same. Any resulting ratemaking changes can and should be addressed in the rate setting process.

62. The contention that the adoption will impose added burdens on regulatory bodies is not without merit. It is true that the final calculations, that is the added step, will require additional efforts. On the other hand, the contentions that more work will have to go in to the preliminary processes merely acknowledges that perhaps not enough attention was being given to the life, salvage and removal estimation processes because within broad averages, errors due to lack of attention went unnoticed. That is not of itself a sufficient basis for denying more precise measures of cost allocation.

63. The proposition that smaller carriers might either be disadvantaged or unable in any event to implement the unit summation process acknowledges something that has long been in existence. In fact, for many of the smaller carriers, the requisite

data necessary to support really fine applications of the vintage group process have been lacking. In its approval of the ELG method, the Commission does not intend to make it, or any other method, mandatory.

64. The question of appropriate depreciation methods for other utilities is an appropriate subject for those authorities having jurisdiction. In the instant order, this Commission addresses depreciation issues for carriers within its statutory authority and responsibility.

65. As stated heretofore, both the impact of revenue requirements and the burdens placed upon the regulatory staffs require consideration. Furthermore, the need for assurance that the reporting and record keeping practices provide adequate safeguards and checks on accountability becomes more critical as the industry continues to grow and change. Therefore, the Commission will direct that implementation be allowed on a progressive basis. During 1981, the staff will address the adoption of ELG by those carriers capable of implementing it and providing adequate supporting and controlling mechanisms and only for new additions to property falling within the broad classification of outside plant. The impact data provided by the carriers indicate that the added revenue requirements would approximate $80 million in 1981. During 1982, the staff and carriers can address adoption of ELG for new additions to property falling within the broad classification of central office equipment. The impact data indicate added revenue requirements for this category of plant would approximate $136 million if implemented in 1981. Delaying implementation by one year is likely to lead to a somewhat higher first year impact. Finally, in 1983 the staff and carriers can address implementation of ELG for all new plant additions to the remaining categories of plant investment. It should be noted that this could conceivably include the categories of station apparatus and large PBX as well as buildings and general equipment and station connections. The impact anticipated from adoption of ELG for buildings and general equipment are expected to be very minimal. The major anticipated impact is expected from station apparatus and large PBX. However, actions being taken in both Docket 20828, the Second Computer Inquiry, and Docket

79-105, Station Connections, are focused on the probable deregulation, or in any event expensing of, the new additions to such investment categories. Such actions are expected to become final in 1982 and therefore the likelihood of application of ELG methods to such property investments is extremely low. The Commission believes that the phasing in of the new methods in this manner will substantially reduce the immediate impacts on both revenue requirements and staff resources.

66. Ninth, the petitioners proposed among other things to have a true-up process approved for application to the errors that would gradually enter into the ELG, or into any other, process. Opponents have stated that the proposed annual true-up process would force state and federal staff experts to concern themselves with addressing changes to every vintage of every category of plant in every year. This appears to be true, and the only immediate solution would appear to be some form of blanket authority to be granted to the carriers. The Commission does not believe that such a blanket approval would be appropriate, nor does it believe that it would meet the requirements of Section 220 of the Act that all changed depreciation percentage rates be prescribed by the Commission. Errors are likely to occur in any method predicated upon estimates of prospective events. We will address corrective measures to be applied to embedded investment in Section X of this order. ELG adjustments will be handled by application of remaining-life adjustments in the setting of rates during the normal represcription process.

VIII. Alternative Methods

67. In the NPRM dated September 19, 1974, at Par. 9, we asked parties to submit alternative methods. Three alternative methods have been presented for consideration. They are as follows:

A. Declining Balance x 1.7

This method was considered by Ernst but lacked any substantial explanative support. The method was offered as a surrogate for achieving the result of ELG without having to

engage in all the extensive work and computations inherent in the ELG method.

Ernst rejected the method as a proper surrogate for ELG. One major drawback was that the factor of 1.7 was only appropriate for the illustrative data submitted by the petitioner in support of its application. The factor of 1.7 was not appropriate for either overall actual conditions or for any particular plant investment category of any real carrier. In short, the factor was a figure that was backed into after first having ascertained the ELG result by application of all of the complexities of calculation of the ELG method.

B. Remaining-Life Method

This method, as an alternative to ELG, was proposed by the California Public Service Commission, which presently employs remaining-life calculations of SLVG rates for intrastate ratemaking purposes in its regulation of the Pacific Telephone and Telegraph Company. It should first be noted that remaining-life is not, as such, a method; it is merely a further step in the calculation of depreciation rates and is a concept that is applicable to almost any method for calculating depreciation rates. The application of remaining-life will be addressed separately further on.

C. Capital Recovery Schedules

The use of capital recovery schedules was recommended by GTE as an alternative to both ELG and SLVG. Such schedules would be precalculated for various investment survivorship patterns and probable average life and total life span that are encountered in experience with telecommunications plant investments. Companies having more advanced capabilities, such as GTE and/or AT&T, could calculate the table of factors to be applied to investments fitting the various survivorship patterns. Smaller companies could then select from among the several choices and apply those factors to their investment. The schedules might not achieve the fine tuned results expected of the larger carriers but should for all intents and purposes achieve reasonable results.

68. In our discussion of the merits of arguments surrounding the adoption or use of the unit summation or ELG method, we reasserted our support of the straight-line allocation standard or pattern while leaving the door open to other allocation patterns if and when proven appropriate and necessary. (See para. 53, *supra.*) We also acknowledged our preference, over the years, for group methods as opposed to unit applications.[5]

69. Within those parameters, we recognize that not all carriers have the requisite data bases or sophisticated resources in terms of modern data processing equipment. Lack of either can be a serious impediment to implementation and application of complex methodologies. The Commission wishes to clarify its belief that the purpose of allocating costs of depreciable plant in a consistent, predictable and rational manner is to achieve as accurate a measure of consumed capital costs as is reasonable of attainment. It is this goal, rather than the particular method, that is of primary importance.

70. The burden of demonstrating that any particular method is both reasonable and practicable for the purposes of meeting the requirements of depreciation accounting is upon the carrier seeking approval of such method or application. The Commission cautions however that alternative or new methods must meet the tests of accountability and generally are more suited for application to prospective property additions, rather than application to presently embedded plant.

IX. Limiting Application of New Methods to New Plant Additions

71. Admittedly, any change in accounting practices entails more work effort. Given the complexity of accounting for telephone property, it seems reasonable to approach such changes on a gradual or phased-in basis.

72. Application of the ELG method requires maintenance of investment and reserve for depreciation data on a vintage level of

[5]As we noted in para. 51, supra, we are prepared to consider unit depreciation proposals in special circumstances.

investment basis. At the present time, AT&T does not have book reserve for depreciation balances at even the plant account or category of investment level, let alone at the more disaggregated vintage level. Under such conditions, it would appear to be impractical to attempt to change to ELG methods for presently embedded plant.

73. If new additions to plant are depreciated under the ELG or some other method, then the balance subject to SLVG depreciation will diminish and ultimately be fully depreciated and retired. In the end result, all methods approach a 100% recovery. Thus by stopping the continued replenishment of investment subject to the SLVG method, the reserve balance attributable to that investment will ultimately approach the same results that would have been attained if the ELG method had been followed.

74. Furthermore, the present embedded investments have other problems associated with them. Specifically, the lack of detailed, disaggregated reserve data impedes development of supporting cost of service data. The lack of reserve accounts by plant investment category or account impedes application of corrective action to overcome real deficiencies of cost allocation and capital recovery arising out of cumulative past errors of life estimation. Lack of detailed reserve information also impedes a ready assessment of the net book cost of investments in categories of plant proposed for deregulation under the provisions of Docket 20828, the Second Computer Inquiry.

75. Properly addressing these problems requires a determination of the appropriate portion of present book reserves to be allocated or identified as being applicable to specific plant investment categories. Continued treatment of present investment amounts on a consistent basis through continued use of the SLVG method is the most logical way to go. Introduction of new methods in mid-stream would only further complicate already difficult problems.

X. Remaining-Life

76. As discussed earlier, there is nothing in the training of experts nor are there any mathematical laws that will impart an

absolute precision to the determinations made under presently known depreciation practice. Consequently, there would appear to be some need for a corrective mechanism if one wishes to attain the goal of assigning or allocating costs over the service life of any particular asset. If actual results appear to be allocating costs faster than necessary to achieve 100% recovery by the likely retirement of a particular investment, then there is a need for a reduction in the current and prospective charges in order to assure that not more than 100% will be charged by the time of retirement. If on the other hand, it appears that retirement will occur before all the costs are allocated, then an equivalent mechanism is needed in order to increase current and prospective charges so that all costs are allocated by the time of retirement. If such circumstances are not self balancing then the likelihood exists that either too much or too little will be allowed to stand in the reserve, perhaps for perpetuity. Such a result is not desirable.

77. At the present time, and over the past decades, depreciation rates calculated by this Commission have been arrived at by a process or final step known as "whole-life." Meritoriously, this approach attempted to calculate the annual charge that would be appropriate, if the currently estimated whole-life of the asset had, in fact, been so determined at the onset of the asset's life. Thus, customers would only be charged costs equivalent to the pro rata portion of total cost applicable to the instant time period. Current customers would not be charged any costs attributable to past periods, nor would they be charged any costs attributable to future time periods.

78. The use of whole-life rate calculations did not create any problems as long as property could be grouped in one very large universe without concern for attributes of any particular type of property, and as long as the overall results achieved tended to approximate theoretical results. This latter condition would occur when various errors of estimate were fully or almost fully compensating. Such conditions appear to have been in existence up to and including the late 1960's. After that, the factors involved in determining lives and types of telecommunications investment began to change more rapidly.

79. The essential difference between whole-life and remaining-life depreciation rate calculations is that the former attempts to determine that annual charge that would be appropriate in the event that the current predictions of whole-life (estimated future life added to current experienced or expired life) were in fact correct. The remaining-life process proceeds on the premise that the current prediction of remaining or prospective life is correct and attempts to allocate any unrecovered or unallocated costs over that time period. That is, the original cost less accumulated reserve, or net unrecovered cost is divided by the prospective remaining-life in order to determine the annual future charges to expense.

80. One requisite for application of remaining-life rates is the ability to determine the current net unrecovered cost. The current reserve for depreciation attributable to the particular book balance of investment must be known if net unrecovered cost is to be determined. Such reserve balances are not available for the AT&T companies.

81. Currently, theoretical measures of the adequacy of carrier book reserves (that is, what the reserve should be based upon current predictions of remaining-life of investments and probable future accruals or allocations of investment costs) indicate that lives have been shortened substantially over previous estimates. The net result is that past allocations of costs to operating periods have been inadequate. If corrective action is not provided for, then at some future date, there will remain on the carrier's books of account a net plant balance, although the physical assets themselves will have been retired from service. Therefore, we will amend our Rules to indicate that, when necessary, we will permit the use of remaining-life depreciation rate calculations.

82. As with any change in the manner of calculating annual expense allocations of such very substantial amounts of money, the application of remaining-life might result in sharp increases in revenue requirements and in user charges. We therefore direct the staff to keep the Commission fully informed as to the difference in amounts of annual charges involved in any recommendations for prescribed rates that it might make. For at least a period of three years, we require that all rates recommended for prescrip-

tion carry with them a statement of the dollar impact in terms of annual expense, as between the rates calculated under the whole-life concept and under the remaining-life concept. Thereafter, the staff is to advise the Commission as to such differences whenever the proposed remaining-life rates result in an increase in proposed annual charges of 115% or more than the increase in annual charges arrived at by calculating whole-life rates.

83. With respect to telecommunications investment, the impact of new technology and the transition from a monopoly to a competitive environment have led to an overall shortening of life estimates. If the currently estimated shorter lives had been known all along, then past depreciation rates would have been higher even under the timing pattern of SLVG, and current reserves would be higher. Absent a reversal of current trends and without corrective action, the amount of difference due to errors of life estimate will continue to grow, and upon ultimate retirement the reserve provisions will not be adequate. It is for this reason that the Commission makes the choice that it must regarding the charging of costs to current and future periods.

84. For those carriers that do not maintain book reserves in sufficient detail to calculate remaining-life rates (e.g., the Bell Operating Telephone Companies), we direct the staff to determine, as expeditiously as possible, the most reasonable allocation of the current book reserves to plant categories. Furthermore, we direct these and all other subject carriers to maintain their book reserves in sufficient detail to allow the determination of depreciation rates by the remaining-life technique for subclasses of property for which depreciation rates are used. It is our desire that these actions not be delayed and that the corrective measures of remaining-life rates be implemented as soon as practicable. It is also our desire that the staff analyze the consequences of alternative reasonable allocations with respect to probable effects on revenue requirements, on the impact of increased expenses on various user groups, and on the incentives for company management to undertake accurate life estimates and to make investment decisions that will promote the public interest.

XI. Special Consideration of Present Investment in Account 232-Station Connections

85. In Docket 79-105, also addressed today, we consider the propriety of continuing the present practice of capitalizing amounts expended in the connection and reconnection of customer station apparatus. This consideration arose out of the findings in Docket 19129. In particular, the amount so invested or capitalized was growing at an extraordinary rate in comparison to growth in other plant investment categories.[6] This was in part due to the accounting treatment of disconnections and reconnections (churning of connections) and in part due to the concept that as such, connections had no particular age life relationship to retirements. The net effect was that annual charges to depreciation expense were designed to offset only the net retirements of any year (disconnects less reconnects), thus resulting in a zero reserve balance. In Docket 19129, it was found that the ultimate effect of this depreciation treatment was not significantly different from the long rejected concept of retirement accounting. Under this concept, annual depreciation charges cover only the year's net retirements and include no provision for the consumption within the year of a portion of the investment in assets still surviving[.][7]

86. In Docket 79-105, we concluded that there is a substantial difference in physical characteristics between the outside or service wire portion of the connection (otherwise referred to as the drop and protector block) and the inside or customer premise portion of connections. In that proceeding we also found that there is not only a strong case for the expensing of the expenditures for the inside portion of the wiring, but also for considering the inside portion to be a part of customer premises equipment rather than a part of carrier plant. To that end, we are issuing in that docket a further notice of proposed rulemaking regarding the detariffing of inside wiring. Because separate accounting treatment of the inside wire is appropriate under either continued

[6] See Final Decision in Docket No. 19129, para. 136. (64 FCC 2d 1, 55 (1977)).

[7] See Initial Decision in Docket No. 19129, paras. 717, 718 and 722. (64 FCC 2d 131, 355-356 (1976)).

expensing or full detariffing we directed in Docket 79-105 that property or investment in Account 232 should be separated into two parts, viz. that representing the outside or company provided customer service wire portion and the inside or customer premise portion of the connection.

87. There are significant differences in the factors affecting the probable service lives of the outside and inside portions of the investment. The outside portion is more subject to the actions of the elements and is also more subject to the actions of public authorities. The inside portion is more susceptible of the vagaries of customer preference, rather than actions of wear and tear, or the elements. In Docket 79-105 we asked the staff to work with the carriers to separate the present investment in Account 232, Station Connections, into its two primary parts as identified herein. We herein direct the staff to then proceed to develop appropriate allocations of the reserve for depreciation and an appropriate depreciation rate for each new investment category. Records are to be in conformity with the requirements of our order in Docket 79-105, although further accounting changes may be necessary to implement the policies adopted in both Docket 79-105 and this docket.

88. The staff and company experts continue to use the negative exponential curve as the basis for prescribing depreciation rates for investment in station connections. This results in a variant of retirement accounting and as such is inconsistent with our general depreciation policy that investment costs be spread in accordance with the straight-line concept over the service life of the asset. Absent further direction in Docket 79-105, the staff should promptly develop a different approach to the calculation of depreciation rates for this investment so that reasonably equal portions of investment will be charged to each of the expected years of the investment's life. This in turn should lead to the development of a positive reserve balance as opposed to the zero balance presently achieved.

XII Conclusions — FCC Policy — Rules — Interpretations

89. It is important to attempt to measure as accurately as possible the consumption of capital in a capital intensive enterprise. Of necessity, however, the measurement process cannot be achieved with absolute precision. Because of this lack of absolute precision, the application of reasoned judgment is often necessary. In practice, there has been a tendency to interpret our rules more restrictively than the actual language requires.

90. With the exception of some modest adjustments, the Commission's rules are for the most part more than adequate. The rules neither condone nor deny introduction of such further refinements as the ELG method, capital recovery schedule methods, or the corrective processes of calculating annual charges by use of the remaining-life concept. In fact, the Commission's rules call for the assignment or allocation of service values over service life, and absent fully compensating changes in life estimates, the use of something akin to remaining-life processes is necessary if those rules are to be satisfied.

91. We have discussed our long-standing preference for group procedures. We have noted that some parts of the rules explicitly provide for remaining-life techniques. The rules also indicate a preference, if not a requirement, that service values be spread over service lives by means of a straight-line method. Appropriate changes to the present rules will be ordered to permit more flexibility in the choice of particular procedures, methods, or techniques used and to correct any inconsistencies in the various parts of our rules. At the same time, we do not wish to foreclose reasonable considerations of alternative methods, applications and measures. To this end, the staff is directed to entertain and analyze such alternative proposals and to make recommendations to the Commission as the appropriateness of the proposals and the resultant depreciation rates.

92. We recognize that any change in accounting methods is not without cost. The implementation of changes may require the company and the commissions involved to devote more resources to the depreciation rate prescription process. Changes may result in increased revenue requirements and lead to rate increases. We

do not find increased rates inconsistent, *per se*, with our mandate, under Section 1 of the Act, "to make available . . . a rapid efficient, nation-wide, and world-wide communication service with adequate facilities at reasonable charges . . . " 47 U.S.C. § 151. We must balance the interests of all present and future customers in the preservation of adequate facilities at reasonable charges. On balance, we find it not unreasonable that present ratepayers incur some additional expense in order to preserve the integrity of the investment and to assure the continued and longer term satisfaction of the requirements of our congressional mandate. The only alternative, continued deferral of both recognition of current costs and initiation of corrective measures to rectify any past unrecovered costs, will require much larger adjustments to be made at some future date.

93. The unit summation (equal life group) process is nothing more than an extension or furtherance of the presently utilized straight-line vintage group method. Its adoption for new property additions would facilitate allocation of costs on a straight-line basis. Alternative methods may also achieve a similar pattern of cost assignment. These alternatives, including the capital recovery schedules concept, might be more appropriate for carriers lacking either the extensive data bases of the larger companies or the sophisticated data processing resources of those companies. Therefore, we will permit the utilization of ELG and alternative methods at the carrier's option, with the provision that implementation must be under the supervision of our staff. The staff will take such measures as may be necessary to insure that proper reporting, record keeping, underlying support data and ultimately measurability and accountability of results are attained.

94. As discussed above, corrective measures are necessary in order to match the recovery of the costs of assets with the service life of the assets themselves. These corrective measures are just as necessary for the present SLVG investments as they are for the prospective investments, whether to be treated under ELG, capital recovery schedules, or some other means. The staff, with the cooperation of the companies, should develop remaining-life rates for both present and prospective plant investments, and present the same to the Commission for consideration. As some carriers

lack the requisite plant category of investment book reserves, the staff should proceed immediately to develop and implement such reserves by allocation of the present overall company reserves. Furthermore, in accordance with Part 31, Section 171 of the Rules, these carriers will maintain their book reserves by accounts corresponding to the depreciable plant accounts.

95. Additionally, the Commission has reiterated its intentions regarding the depreciation of the investment in Account 232 as set forth in its decision in Docket 19129. The Commission finds that its intentions, that this account be depreciated in accordance with the straight-line concept as generally understood, are not being met. Absent further direction in Docket 79-105, the Commission directs the staff to proceed immediately to overcome this problem by developing appropriate means of assuring that the depreciation rates for this account will in fact apportion relatively equal amounts of investment to each of the several years during which the investment remains in service.

96. Lastly, the Commission chooses to address the proper role of staff in the analysis and assessment of carrier proposals for depreciation rates. Depreciation rate proposals and supporting data and analyses are submitted to the Commission by carriers who obviously have a significant financial interest in the rates which are ultimately prescribed. As a result, it is essential for the staff to review them with a healthy skepticism; however, the staff must not lose sight of the primary goal of the process which is to distribute the full cost of an asset in a reasonable manner over its service life. To achieve this goal the staff must aim at the most accurate measurement of lives and salvage values reasonably attainable. To do otherwise would be misleading to the regulators having to reach final ratemaking decisions, and could result in improper conclusions to the detriment of both customers and investors. In arriving at its reasoned judgments, however, the staff must analyze the probable consequences vis-a-vis our paramount public interest perspective.

97. In addition to reports regarding appropriate lives, salvage percentages, and depreciation rates, the staff should advise the Commission of any questionable carrier activities or practices

affecting depreciation rates which come to light during the course of the staff investigations.

XIII Ordering Clauses

98. Accordingly, IT IS ORDERED, pursuant to Sections 4(i), 4(j), 220, of the The Communications Act of 1934, as amended, that the policies and rules set forth herein ARE ADOPTED as a final decision in Docket No. 20188.

99. IT IS FURTHER ORDERED THAT Parts 31, 34, and 35 of the Commission Rules ARE HEREBY AMENDED, effective July 1, 1981, as reflected in the Appendix.

100. IT IS FURTHER ORDERED THAT the Final Report issued by Ernst & Ernst under contract to the Commission, which was dated July 29, 1977, together with comments thereon submitted under the aegis of FCC Public Notice No. 88859, dated September 8, 1977, are incorporated into the record of this proceeding.

101. IT IS FURTHER ORDERED THAT Docket No. 20188 is HEREBY TERMINATED.

102. IT IS FURTHER ORDERED THAT The Secretary shall cause a copy of this decision to be published in the Federal Register.

FEDERAL COMMUNICATIONS COMMISSION,
WILLIAM J. TRICARICO, *Secretary*.

Appendix 1.

1. In Part 31, Section 31.02-80, (a) is amended and (d) is added to read as follows:

§ 31.02-80 Computation of depreciation rates.

(a) Unless otherwise provided by the Commission, either through prior approval, or upon prescription by the Commission, depreciation percentage rates shall be computed in conformity with a group plan of accounting for depreciation and shall be such that the loss in service value of the

property, except for losses excluded under the definition of depreciation, may be distributed under the straight-line method during the service life of the property.

* * *

(d) Companies, upon receiving prior approval from the Commission or, upon prescription by the Commission, shall apply such depreciation rate as will amortize the difference between the net book cost of a class or sub-class of plant and its estimated net salvage during the known or estimated remaining service life of that plant.

2. In Part 31, Section 31.171, (c) is amended to read as follows:

§ 31.171 Depreciation Reserve.

* * *

(c) The company shall maintain this account broken down by accounts corresponding to the classes of depreciable telephone plant accounts itemized in Part 31, Section 31.02-82. These accounts shall show the current credits and debits to the reserve in complete detail.

3. In Part 34, Section 34.04-2, (d) is added to read as follows:

§ 34.04-2 Computation of depreciation rates.

* * *

(d) The Commission's preference is that depreciation rates and charges be calculated by application of a generally accepted group method applied in a manner to accomplish a straight-line allocation of service value. However, a carrier, upon receiving prior approval from the Commission or, upon prescription by the Commission, may apply depreciation rates determined by use of other methods or allocation patterns.

4. In Part 35, Section 35.04-2, (d) is added to read as follows:

§ 35.04-2 Computation of depreciation rates.

* * *

(d) The Commission's preference is that depreciation rates and charges be calculated by application of a generally accepted group method applied in a manner to accomplish a straight-line allocation of service value. However, a carrier, upon receiving prior approval from the Commission or, upon prescription by the Commission, may apply depreciation rates determined by use of other methods or allocation patterns.

FCC 81-350

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

Washington, D.C. 20554

Docket No. 20188

In the Matter of

Amendment of Part 31 (Uniform System of Accounts for Class A and Class B Telephone Companies) so as to permit depreciable property to be placed in groups comprised of units with expected equal life for depreciation under the straight-line method.

ORDER ON RECONSIDERATION

(Adopted: July 30, 1981; Released: August 18, 1981)

BY THE COMMISSION: COMMISSIONER WASHBURN ISSUING A SEPARATE STATEMENT; COMMISSIONER FOGARTY ISSUING A SEPARATE STATEMENT IN WHICH COMMISSIONER QUELLO JOINS; COMMISSIONER DAWSON ABSTAINING FROM VOTING.

1. Introduction

1. On December 5, 1980, the Commission released its *Report and Order* in Docket No. 20188, 83 FCC 2d 267 (1980), to permit Class A and B telephone companies to use Straight Line Equal Life Group (SLELG) and remaining-life depreciation procedures. A Petition for Reconsideration was filed on February 26, 1981, by the National Association of Regulatory Utility Commissioners (NARUC). Oppositions to this Petition were filed by GTE Service Corporation (GTE) and the American Telephone and Telegraph Company (AT&T). A Reply to these oppositions was filed by NARUC. A Petition for Clarification was filed on February 13, 1981, by GTE. An Opposition to this Petition was filed by NARUC on March 30, 1981. GTE replied on April 13, 1981. Each of these petitions will now be considered.

II. NARUC's Petition

2. In its petition NARUC argues that the changes adopted in the Commission's *Report and Order*, namely, the adoption of SLELG as an approved depreciation method for new plant and the use of remaining-life for embedded plant, will substantially increase revenue requirements and thereby subscriber rates and that the Commission should therefore reconsider the disadvantages of these changes in light of the already increased revenue requirements brought about by its decisions in *Computer Inquiry II* and *Docket No. 79-105* (Expensing of Station Connections).[1] NARUC argues that the SLELG method is no more accurate than the currently used Straight Line Vintage Group (SLVG) method; that the SLELG method is accelerated in comparison with SLVG; that the adoption of SLELG will result in increased costs for both telephone companies and state commissions because of difficulties in implementation; that SLELG depreciation procedures will increase the advantages which large companies held over their smaller competitors; and that the inadequacies of the current SLVG whole-life procedure might be cured by more realistic estimates of the life of depreciable property[2], disaggregated salvage estimates and more homogeneous groupings of plant.

3. AT&T and GTE in their opposition to NARUC's Petition for Reconsideration note that NARUC's arguments against SLELG are the same arguments it has made repeatedly throughout this proceeding. They state that these arguments have already

[1] For the *Second Computer Inquiry See In the Matter of Amendment of Section 64.702 of the Commission's Rules and Regulations* (Final Decision), 77 FCC 2d 384 (1980), *recon. in part*, 84 FCC 2d 50 (1980). For the Expensing of Station Connections *See In the Matter of Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies, of the Commission's Rules and Regulations with respect to accounting for station connections, optional payment plan revenues and related capital costs, customer provided equipment and sale of terminal equipment*, 85 FCC 2d 818 (1981).

[2] NARUC suggests in this regard that equipment lives are largely under the control of the major telephone companies.

been considered by the Commission and rejected. Further, AT&T observes that if circumstances have changed since comments were filed, NARUC has not cited them in support of its Petition. Accordingly, they request that the Commission deny NARUC's Petition for Reconsideration.

4. We agree with AT&T and GTE that NARUC's arguments for reconsideration were fully considered by the Commission in reaching its original decision. Having no new arguments or facts before us, and believing that our original decision was sound, we reject NARUC's Petition for Reconsideration as discussed below.

5. NARUC argues that we have not given adequate consideration to the increased revenue requirements, and ultimately carrier rates which would be generated by the change in depreciation methods we have ordered. Under normal circumstances it is settled law that capital prudently invested in a regulated public utility must be recovered through annual charges to depreciation expense. The depreciation process spreads this recovery over the average estimated service life of the various plant categories in such a way as to provide full capital recovery. The only question addressed in this proceeding is the speed at which this recovery will occur; i.e., the allocation of the cost among present ratepayers and future ratepayers. The Commission has recognized, as have all parties to this proceeding, that the change to SLELG would result in higher revenue requirements initially and, thereby, higher customer charges. Under the circumstances here, as we found in the original decision, increased revenue requirements for an initial period are not *per se* inconsistent with our mandate under Section 1 of the Act "to make available . . . a rapid, efficient, Nation-wide, and world-wide . . . communication service with adequate facilities at reasonable charges . . . . " 47 U.S.C. § 151. We are convinced that we have taken the appropriate steps to bring the communications carriers depreciation reserve and future recognition of depreciation expenses more in line with actual rates at which the assets are being consumed and more in line with today's technology and economic conditions. We believe that the public will benefit from enlightened accounting and depreciation policies which encourage technological innovation.

The impact of these increases will be ameliorated by the phase-in of SLELG directed in our *Report and Order*.

6. NARUC suggests that more reasonable life estimates, disaggregated salvage estimates, or more homogeneous accounts could alleviate the problems with SLVG. These arguments miss the mark. NARUC appears to be suggesting that inaccurate life estimates be made in the depreciation rate-setting process to compensate for the inadequacies in SLVG. The better approach, and the one adopted by the Commission, is to continue to make the most accurate life estimates possible and to change the depreciation method to more accurately provide for capital recovery at a rate representative of the actual consumption of the property. The difference between SLELG and SLVG is in the approach taken to spreading the service value over the estimated average service life of the assets comprising the depreciation category, not in the estimation of average service lives. The average service life under either approach will be the same. As our *Report and Order* found, straight line depreciation is generally the preferred method. SLVG is a decelerated depreciation method when compared with the depreciation that would result if straight line unit depreciation were used. While such a decelerated method might have been acceptable in a monopoly environment, the delayed capital recovery under such a method has become less attractive with the increase in competition which has developed over the past decade. Therefore, changing the life estimation process will not correct SLVG's deficiencies. Furthermore, we do not believe that the disaggregation of salvage estimates will correct these deficiencies. NARUC has not indicated how this change in salvage estimation procedures would in any way significantly shift capital recovery over the average service life of a depreciation category. Given the existing Uniform System of Accounts for telephone companies contained in Part 31 of the Commission's Rules, 47 C.F.R. § 31.01-1 *et seq*, the development of more homogenous depreciation categories is infeasible because of a lack of sufficient plant disaggregation. Therefore, NARUC's alternatives would not deal with the need to improve capital recovery promptly in light of competitive and technological conditions in the marketplace.

7. NARUC's claim that the large companies control technological change, and therefore service lives, is equally unavailing with respect to the question of depreciation method. Rather, the control argument addresses problems of life estimation, which, as we have previously noted, are common to both SLELG and SLVG. This is not to say that the selection of a depreciation method may not indirectly affect the rate of equipment replacement but only that these indirect effects are insufficient to outweigh the need for improved capital recovery.

8. It is likely, as NARUC contends, that the adoption of SLELG will increase somewhat the demands on commission staffs. This is unavoidable if adequate capital recovery is to be assured. An orderly transition in depreciation rate prescription procedures must be established if commissions are to fulfill their obligations to ratepayers and the companies they regulate, and this obviously requires some additional expenditure of staff resources. We believe that the phased implementation approach balances the capital recovery and staffing problems in a reasonable way. NARUC has not presented a viable alternative that would further reduce staffing costs while assuring adequate capital recovery.

9. NARUC's argument as to the potential impact on small carriers is also not persuasive. We did not mandate that all carriers must use SLELG. Therefore, if a small company feels that the new methods would have an adverse impact on its operations it can continue with its present method. Furthermore, we find no competitive inequity in this result since, as AT&T notes, the smaller carriers in most instances are not competing with the larger carriers.

III. *GTE's Petition*

10. In its Petition, GTE sought clarification on several points, including the manner in which the depreciation changes would be implemented. Specifically, GTE has requested the following "clarifications":

(1) Amendment of Section 31.02-80 to correspond with related sections of Parts 34 and 35 to indicate similarity of treatment for all carriers;

(2) Amendment of Section 31.171(c) to provide for the recognition of the possibility of separate reserves for original cost and net salvage;

(3) Adoption of a policy requiring a decision within ninety days of the filing of depreciation represcription requests;

(4) Change of the implementation of SLELG to allow outside plant and central office equipment to be prescribed in 1981 effective January 1, 1982, with remaining-life rates for all accounts to be prescribed in 1981.

(5) Adoption of a zone of reasonableness to be applied to recurring filings; and

(6) Deletion of the policy requiring whole-life and remaining-life submissions after the first three year represcription period.

NARUC has opposed GTE's Petition in substantial part. Each of GTE's requests, as well as NARUC's objections, is considered *seriatim* below.

11. *Amendment of Section 31.02-80.* GTE proposes revised language for Section 31.02-80 that it feels will reflect the intent of the Commission more precisely and will indicate that the Commission intended the same policy to apply to Part 31 as applies to Parts 34 and 35. In the original decision, Section 31.02-80(a) was amended to read:

> Unless otherwise provided by the Commission, either through prior approval, or upon prescription by the Commission, depreciation percentage rates shall be computed in conformity with a group plan of accounting for depreciation and shall be such that the loss in service value of the property, except for losses excluded under the definition of depreciation, may be distributed under the straight-line method during the service life of the property.

GTE proposes to amend subparagraph (a) to read:

> The Commission's preference is that depreciation rates and charges be calculated by application of a generally accepted group method applied in a manner to accomplish a straight-line allocation of service value. However, a carrier, upon receiving prior approval from the Commission or, upon prescription by the Commission, may apply depreciation rates determined by use of other methods or allocation patterns.

NARUC believes that accelerated methods are rarely advisable in the regulated environment and would require a carrier seeking an alternate method to bear the burden of clearly and convincingly demonstrating that such method is superior to the straight-line method. NARUC seeks incorporation of this standard as part of the Rule.

12. GTE has correctly noted that a language discrepancy exists between Part 31 and Parts 34 and 35. Although these language differences are not so diverse as to produce contrary results, the suggested change will clarify our intent to treat all carriers alike. We will therefore adopt GTE's suggested change. The deletion of the language "except for losses excluded under the definition of depreciation" from Section 31.02-80(a) adopted in the original decision is not significant. This caveat is the subject of Section 31.02-83[3] and is adequately covered by the language of that Section.

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[3] Section 31.02-83 provides in pertinent part:

> If the cause of retirement is not a recognized factor in depreciation and the loss is not covered by insurance, the company may upon proof that the charge to the depreciation reserve will result in undue depletion thereof, and with the approval of this Commission, credit account 171, "Depreciation reserve," and charge account 138, "Extraordinary maintenance and retirements," with the unprovided-for loss in service value and distribute it from that account to account 609, "Extraordinary retirements," over such period as this Commission may approve.

13. In paragraph 70 of the orignial decision the Commission indicated that "[t]he burden of demonstrating that any particular method is both reasonable and practicable for the purposes of meeting the requirements of depreciation accounting is upon the carrier seeking approval of such method or application." 83 FCC 2d at 287. We believe that this statement of policy when read with the prior approval language of Section 31.02-80(a), as amended herein, is adequate to allay NARUC's concerns. We would agree, nevertheless, that any alternate depreciation method must be consistent with the public interest objectives expressed in Section 1 of the Act.

14. *Amendment of Section 31.171(c)*. GTE proposes revised language to be incorporated into our amendments to Section 31.171(c) to authorize the use of separate reserves for original cost and net slavage.[4] GTE argues that its proposed change would allow precise recovery of each vintage of original cost and, at the same time, allow adjustments for proper levels of annual cost of removal and salvage. As GTE points out, paragraph 52 of the original decision recognizes that it may be necessary to keep accumulated depreciation at different levels of aggregation for original cost and for net salvage in order to implement SLELG. If that is done by a carrier, separate reserves for original cost and net salvage for each depreciable plant category will be required.

[4] GTE proposes adding the following to paragraph (c):

Each carrier may separate accounting for salvage from depreciation accounting. For the purpose of accounting for salvage, each carrier shall either:

(a) accrue annually for the estimated net salvage proceeds during the life of the assets, or

(b) recognize net salvage as realized, provided that the carrier has satisfied the Commission that such accounting treatment would not have a significant impact on the financial results of the carriers. The selection of one of the above accounting treatments for each class of asset shall not be altered without prior Commission approval. If, in a given year, a carrier should experience extraordinary cost of removal or gross salvage, the carrier shall immediately advise the Commission which, after consulting the carrier, will determine an appropriate course of action.

Section 31.01-2(d)(1) allows carriers to keep additional subaccounts as long as the integrity of the accounts is maintained. Accordingly, it is not necessary to specify that additional subaccounts may be kept. Furthermore, we are not convinced that the two options set forth in GTE's proposal are consistent with the Commission's intentions as set forth in paragraph 52. GTE has not described, in any detail how either of the two alternatives suggested would be implemented, nor has it supplied the revenue requirement effects of either option. However, it appears that both methods may result in a decelerated recognition of salvage effects. In fact, the second alternative could possibly be intended to place the accounting for net salvage outside the depreciation process. This was clearly not contemplated by the Commission, nor has GTE justified the adoption of such an approach. In light of GTE's failure to adequately support its proposal, and the Rule proviso permitting additional subaccounts, we believe the detailed implementation of our order is best handled by the staff of the various commissions working with the carriers. This will allow the carriers and the commission staffs to implement plans that will best meet the needs and conditions of each of the carriers and commissions. If additional subaccounts are necessary, they may best be selected once the implementation methods have been established.

15. *Ninety Day Deadline.* GTE has requested that the Commission adopt a policy of acting on represcription applications for SLELG and remaining-life not later than ninety days following submission. GTE maintains that its companies need a response within this time frame to avoid adverse financial consequences from depreciation rates being implemented on a retroactive basis. In its opposition NARUC argues that the urgency that GTE refers to in its Petition is purely fictional because not only is the use of SLELG and remaining-life optional for all carriers, but the retroactive effectiveness of any approved depreciation rates is also optional. NARUC suggests that GTE adopt a flexible approach in implementing the increases by coordinating the timing and the implementation of a SLELG/remaining-life changeover with the effectiveness of tariffs reflecting these revenue requirement increases. NARUC also argues that a ninety day time limit for

action on a represcription request could affect the inclusion of the states in the three-way meetings.

16. GTE's argument on the adverse impact of the retroactive application of depreciation rates is not well-founded. Section 43.43 of the Rules, 47 C.F.R. 43.3, provides for the filing of requests for depreciation rate changes at least ninety days prior to the last day of the month with respect to which the revised rates are first to be applied in the accounts. It also states that the application shall state the date on which the rates are to be made effective. There is nothing in the Rules that prevents a carrier from filing its application more than ninety days prior to the last day of the month with respect to which the revised rates are first to be applied in the accounts. Subsection (e) which provides for retroactive application of the depreciation rates to the beginning of the year is permissive, not mandatory.[5]

17. This commission is charged with the responsibility of approving depreciation rates for communications carriers subject to Section 220(b), 47 USC 220(b). In this *Docket,* we have adopted a change in depreciation methods that the carriers will be allowed to use (SLELG) as well as revised the existing procedures that can be used with embedded plant (remaining-life). These changes will create a large number of filings for both SLELG rates and remaining-life rates. It would be unwise for us to adopt a strict time frame for responding to represcription requests when we are sure that our staff work load, as well as that of the states, will increase significantly in the very near future. Moreover, at a time when such major changes are being put in place we believe, contrary to GTE's contention, it is prudent to continue active state involvement in the three-way meeting process.[6] A ninety day restriction could easily limit this Commis-

[5] Section 43.43(e) provides that "such rates may be made retroactive to a date not prior to the beginning of the year in which the filing is made. . . . "

[6] This is not to say that three-way meetings are required by statute. Although this question is not before us, it is possible that other forms of state participation would satisfy the requirements of Section 220(i), 47 USC 220(i).

sion's ability to properly discharge its responsibility to set depreciation rates. We note that in the past our approval time on represcription requests has been close to the ninety days that GTE requests. However, this was prior to our adoption of the option of SLELG and remaining-life depreciation procedures. We were able to respond to a depreciation rate request in this time frame in prior periods because of the cooperation of the carriers and commission staffs. We will continue to work with the carriers and strive to resolve, with the concurrence of the states, all depreciation filings on a timely schedule. However, we will not bind ourselves to a deadline which may, in certain cases, not allow for adequate consideration of the rates filed. To commit ourselves in such a manner would not be consistent with our overriding obligation to protect the public interest.

18. *Timing of implementation of new methods.* GTE has requested that we review and approve new SLELG depreciation rates for both the outside plant and central office equipment accounts in 1981 to allow GTE companies to implement the new rates effective January 1, 1982. GTE also requested that we review and approve new remaining-life depreciation rates for all accounts in 1981. It argues that if approval of new rates is made retroactive, it may be forced to bear the additional expenses without the opportunity to collect the increase in revenue requirements. NARUC points out that there is no requirement that GTE make any depreciation rates effective retroactively and in fact the carriers could coordinate the implementation of the new depreciation methods with filings for additional revenues with the respective state commissions.

19. GTE has also raised the problem of "retroactivity" in connection with its "timing" argument. As we noted in paragraph 16, however, retroactivity is optional with the carrier and there is little possibility that it will be forced to bear expenses that it is unable to collect because of a retroactive application of depreciation rates. Furthermore, as we noted in our *Report and Order,* 83 FCC 2d at 284-5, one of the primary reasons we adopted a phase-in of SLELG was the added burdens its implementation will place on regulatory bodies. The adoption of remaining-life depreciation procedures compounds the work requirements on these

staffs, especially during the transition years. We realize that the carriers have a financial interest in obtaining as rapid approval of new depreciation rates as possible. On the other hand, the regulatory commissions have the responsibility of assuring themselves that the requested rates properly reflect the consumption of capital for the various items of plant. NARUC's Petition for Reconsideration also notes that implementation of our *Report and Order* will place additional burdens on the majority of the state commission staffs. These additional staff efforts are caused by the simultaneous adoption of SLELG depreciation methods and remaining-life procedures. We fully intend to work with the state commissions to ensure that the new rates prescribed for both SLELG and remaining-life are properly supported. In general, where circumstances permit, we intend to use the three-way represcription meetings to prescribe new remaining-life rates.

20. In the *Report and Order* the staff was directed to address the adoption of SLELG for new additions to outside plant in 1981, for new additions to central office equipment in 1982, and for new additions to the remaining categories of plant in 1983. Given the limited availability of staff resources, there is uncertainty as to whether the first step in implementation of SLELG rates can be accomplished in accordance with this schedule; nevertheless, the staff is directed to make every effort to meet these objectives.

21. *Adoption of a Zone of Reasonableness.* GTE has proposed filing annual remaining-life adjustments and has urged that as long as the rates requested are in a "range of reasonableness" that the requested rates be approved without detailed analysis. The company argues that nothing in our *Report and Order* precludes annual filings, and detailed analysis of these filings is no longer required because the use of remaining-life will assure recovery of no more than the full investment. NARUC, on the other hand, contends that the range of reasonableness approach by GTE appears to advocate a rubber-stamp approach and abandons the three-way meeting process.

22. GTE has not defined "zone of reasonableness" nor has it discussed how such a concept would be implemented. It is unclear how the zone of reasonableness is to be determined, what

guidelines would determine when the zone would be changed, and whether a similar zone would apply to all plant categories. Moreover, GTE's concern should affect only a limited number of depreciation categories, i.e., those with the shortest remaining-lives. With the instructions to the staff contained in paragraph 23, we believe adequate staff flexibility exists to accommodate any short term implementation considerations. Furthermore, as we observed in our original decision, Section 220(b) of the Act requires the Commission to prescribe any changes in depreciation rates. To the extent GTE's proposal would allow a carrier to change a rate without a Commission prescription, questions arise as to its lawfulness under Section 220(b) of the Act. Accordingly, the adoption of a zone of reasonableness at this time is unnecessary, and would be infeasible without more detailed specification and public comment thereon.

23. GTE observed that nothing prohibits it from filing annual remaining-life represcription requests to reflect the decline in the average remaining-life of any depreciable plant category. NARUC considers such annual filings to be impractical. We recognize the potential impact upon both state and federal commissions involved in any such annual filings. However, the Commission does not intend to preclude the staff or the carriers from pursuing any implementation procedures which will expedite the depreciation ratemaking process. In fact, the Commission continues to encourage participants in the process to seek approaches that will minimize the filing burdens while ensuring that the Commission's statutory responsibilities are satisfied.

24. *Deletion of Parallel Whole-life/Remaining-life Submissions After First Represcription Period.* GTE urges the Commission to consider revising its statement in paragraph 82 requiring the submission of both whole-life and remaining-life studies beyond the initial three-year represcription. GTE submits that these studies are not in the spirit of deregulation and are largely duplicative. NARUC has not opposed this request.

25. A reading of paragraph 82 indicates that continuing studies under both methods would be necessary to determine whether "the proposed remaining-life rates result in an increase in proposed annual charges of 115% or more than the increase in

annual charges arrived at by calculating whole-life rates." 83 FCC 2d at 290. Whenever this occurs, the staff is to advise the Commission. On reconsideration, this general continuing requirement to file whole-life and remaining-life studies does appear to be overly burdensome since no whole-life depreciation rates would be prescribed and the procedures outlined below will be adequate to spot those instances where continued parallel filings may be beneficial. Accordingly, at the time of the parallel filing for the first represcription the staff shall review the divergence between the two methods and report this to the Commission as required by paragraph 82. It shall also analyze the filings to determine whether deplicative filings for the next represcription will be beneficial, and, if so, the represcription order will set forth the requirement to be met. Otherwise, the parallel filing requirement will be discontinued for that company.

IV. *Ordering Clauses*

26. ACCORDINGLY, IT IS ORDERED, That the Petition for Reconsideration of the National Association of Regulatory Utility Commissioners is Denied.

27. IT IS FURTHER ORDERED, That the Petition for Clarification filed by GTE Service Corporation is Granted in Part to the extent indicated herein and otherwise Denied.

28. IT IS FURTHER ORDERED, That the Secretary shall cause a copy of this Order on Reconsideration to be published in the Federal Register.

29. IT IS FURTHER ORDERED, That under authority contained in Sections 4(i), 4(j) and 220 of the Communications Act of 1934, as amended, Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies IS AMENDED as set forth in the attached Appendix.

FEDERAL COMMUNICATIONS COMMISSION,
WILLIAM J. TRICARICO, *Secretary*.

Appendix

Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies, is amended as follows:

> In Part 31, Section 31.02-80(a) is amended to read as follows:
>
> (a) The Commission's preference is that depreciation rates and charges be calculated by application of a generally accepted group method applied in a manner to accomplish a straight-line allocation of service value. However, a carrier, upon receiving prior approval from the Commission or, upon prescription by the Commission, may apply depreciation rates determined by use of other methods or allocation patterns.

SEPARATE STATEMENT OF COMMISSIONER ABBOTT WASHBURN

IN RE: EQUAL LIFE GROUP DEPRECIATION PROCEDURES DOCKET NO. 20188

Our November 6, 1980 Report and Order[1] recognized there would be added work for this Commission, the State Commissions and the companies who will use the new depreciation procedures. Accordingly, we included a phased implementation of Equal Life Group (ELG) depreciation for new plant. Today the staff told us that with existing staff resources it is impractical to expect to meet the scheduled implementation of ELG for outside plant in 1981. The staff, nevertheless, was asked by the Commission to adhere to the original schedule to the degree possible.

It is much in the public interest, as we move into a competitive era in voice and data transmission, that companies be allowed to recover capital consistent with the realities of the new and rapidly changing technology. Therefore it would give the wrong signal as

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[1] Amendment of Part 31 (Uniform System of Accounts for Class A and Class B Telephone Companies) so as to permit depreciable property to be placed in groups comprised of units with expected equal life for depreciation under the straight-line method. 83 FCC 2d 267 (1980).

to our firm intent, were we now to slip the schedule by a year, after having adopted it just seven months ago. We recognized in November that there would be a strain on our personnel.

However, with the massive tasks ahead and with but four Depreciation Rate Engineers on the Common Carrier staff, it would be unfair to expect miracles. These experts are of the highest caliber. They are putting forth extra effort to meet the goals set by the Commission. But clearly, as Chairman Fowler put it, they can't take the hill without reinforcements.

To help resolve the problem, I suggest:

- That the Commission, with all vigor, make more staff resources available—whether through reassignment, permanent additions, or hiring of consultants, as soon as possible.
- That the staff diligently pursue new and streamlined approaches and procedures.
- That the companies prioritize their filings and adopt realistic expectations during the difficult transition period.
- That the Commission review progress at a meeting during the fourth quarter of 1981.

Separate Statement of Commissioner Joseph R. Fogarty

In Re: Amendment of Part 31 (Uniform System of Accounts for Class A and Class B Telephone Companies) so as to permit depreciable property to be placed in groups comprised of units with expected equal life for depreciation under the straight-line method.

I strongly support the Commission's decision to attempt to adhere to the original schedule for the implementation of the Equal Life Group (ELG) procedure for property depreciation. It is essential that ELG be implemented on schedule. Most telephone companies are currently operating with inadequate reserves, and further delay in the implementation of ELG would only serve to compound an already serious problem—a perennial problem whose history suggests the remedy the Commission should adopt to avert a real disaster.

In our *Property Depreciation* Order adopted in November, 1980, we held that the ELG procedure was an acceptable method of straight line depreciation. *Property Depreciation*, 83 FCC 2d 269 (1980). Pursuant to the schedule established in that Order, telephone companies were permitted to implement ELG for new additions to outside plant during 1981, new additions to central office equipment (COE) in 1982, and new additions to the remaining categories in 1983. 83 FCC 2d at 285. In acknowledging the advantages of ELG, we stated:

> "if the public is to realize the benefits of advances in communications, it is necessary that accounting and depreciation rules not stifle innovation and inhibit the introduction of new technology." 83 FCC 2d at 281.

We found it crucial that the companies, their customers, and their investors, as well as the regulators, all have an accurate and objective financial picture of the companies' operations and capital requirements. The Commission concluded that the implementation of the ELG method of depreciation would play an important role in meeting this need because it appeared "to calibrate more closely the flow of revenues with the recovery of capital." 83 FCC 2d at 281. We found also that the use of ELG was in the public interest as it would enhance the ability of regulated telephone companies to continue to provide "... rapid, efficient... communication service with adequate facilities at reasonable charges." 83 FCC 2d at 281.

To delay implementation of ELG based on the fear that staff resources are not adequate to meet demands of the ELG implementation timetable would be the wrong solution. In addition to implementing the first phase of ELG, the Bureau, by the end of the year, must also prescribe remaining-life depreciation rate calculations for all of the 1981 companies, represcribe terminal equipment depreciation rates, and represcribe depreciation rates for station connections—other subclass of plant. However, ELG should not be sacrificed to these other demands. If *Computer II* is to be implemented and the telephone companies permitted to

enter the new age of competition with parity, all these depreciation changes—including ELG—should be implemented promptly, and by the end of 1981.

I agree with GTE that the Commission should review and approve new ELG depreciation rates for both outside plant and COE in 1981 to allow companies to implement the new rates on January 1, 1982. Telephone companies should not be forced to apply new depreciation rates retroactively and thereby run the risk of being unable to have the consequent increases in revenue requirements recognized in corresponding rate increases under state regulation. It is essential that depreciation rates be matched with revenue dollars.

I also agree with GTE's proposed "zone of reasonableness" concept under which it would file annual remaining life adjustments which would be approved as long as the requested rates fall within a "range of reasonableness." However, I believe that any further consideration of this point should be delayed until after the implementation of the first phase of ELG depreciation.

I am disappointed that the first time the Commission has had the opportunity to grapple with the actual implementation of our competitive common carrier policies, the staff recommended a one-year postponement of the imperative based on the claim that sufficient personnel to accomplish the job were lacking. If we fail to implement ELG now in a timely fashion because of lack of staff resources, our ability to implement *Computer II* is also put in question. If we were to indulge in a one-year delay to give the Bureau more time to analyze cost recovery issues, what would we face next year when the same staff will have the gargantuan task of valuating the $10 billion assets assigned to the new AT&T unregulated subsidiary? The summer of '81 would seem somnolent and easy going in comparison.

For this Commission to waver now in its commitment to accelerated capital recovery would not only be an embarrassment to the agency, it would indicate an ambivalence on our part and invite an attack on our decision to allow ELG and more rapid cost recovery, as well as our other competitive policies. For these reasons, it is imperative that Commission action in the capital

recovery area proceed promptly. I am pleased to comply with Chairman Fowler's request that I work directly with the Bureau to accomplish this critical task and propose later in this statement a procedure for the Commission to adopt to meet the necessary time-table.

This is not a commitment that I make either lightly or naively. The capital recovery issues to be faced are complex and may ultimately involve major depreciation policy changes. From the beginning, telephone company depreciation has focussed on the financial and accounting management of the capital investment of the largest and most capital intensive business in the world. While the economy enjoyed prolonged periods of relative economic stability and the industry enjoyed a *de facto* monopoly market, this Commission and state commissions believed it was in the public interest to delay timely capital cost recovery by the telephone industry. Regulators in effect substituted their judgment for that of telephone company management regarding depreciation in order to maintain low monthly customer charges.

The pace of technological development, escalating inflation, the erosion of monopoly protection by the introduction of competition into the field of telephony—all have joined to destroy the peaceful, permissive atmosphere which previously existed.

The telephone industry faces a crisis. Present and prospective capital investments of the industry are endangered now by procrastination and delays in timing of cost recognition. These dangers are real and they pertain to the entire industry—from AT&T to the smallest of the Independents. The crisis has been heightened by recent decisions of the Commission to deregulate substantial areas of telephone equipment which represent a substantial investment.

In this docket, we did identify capital accounting measures and means to attack the problems of past and current deferral of those costs. Nevertheless, the Commission unfortunately bogged down in the effort to adopt remaining life rates and modernize straight-line allocation of costs. In my view, the principal cause of this crippling delay is the Commission's unyielding adherence to prolonged exercises in the estimation of lives, together with

attempts to develop and impose finite controls to assure absolute precision. The delays are unwarranted precisely because this whole process is one of estimation and not one of precision. The only control over the process that this Commission need exercise is to assure that no more than 100% of costs be recovered. Current measures of recovery fall far too short. The Commission's past record of achievement in the area of cost recovery is inadequate. Yet, the Commission still appears determined to resist needed changes—to hold down revenue requirements for yet a while longer—to postpone the inevitable.

The only solution to this problem, I believe, is for the Commission to move forward expeditiously, with the cooperation of state regulatory agencies and the carriers to implement corrective cost recovery measures needed now—not later. Deferral of action is dangerous and will compound the massive problem that must be confronted.

Although the Communications Act (47 U.S.C. 151 *et. seq.*) charges the Commission with the sole responsibility to prescribe accounting methods and depreciation rates to be followed by subject carriers (47 U.S.C. 220) and affected states must be afforded an opportunity to comment, the rulemaking process does not require prolonged notice and hearing (5 U.S.C. 553). I have consistently encouraged dialogue and development of an efficient working relationship with the states. In more tranquil times, the traditional three-way meetings, among the FCC, the carriers and the state regulatory commissions, proved to be an excellent means of assessing the position of the states. Now, however, the exigencies of the times, the lack of sufficient Commission funding and staff resources require that we find a more efficient means of implementing cost recovery procedures than the venerable tripartite meetings.

This requires that regulators and the industry cooperate in an effort to resolve the problem of capital recovery. Action must be taken by the end of 1981 or we will lose control of the situation.

The only solution with merit that I have found is for the Commission to establish a working group in the Common Carrier Bureau, similar to the group of parties in interest which negoti-

ated the ENFIA arrangement. *Exchange Network Facilities (ENFIA)*, 71 FCC 2d 440 (1979). This Cost Recovery Group under the supervision of an FCC Commissioner would be composed of the parties in interest: NARUC, the subject carriers represented by AT&T, GT&E, and USITA, and the Bureau staff.

The group should be charged with addressing implementation this year of remaining life rates for the embedded investment of all carriers; the implementation this year of Equal Life Group depreciation rates for the Outside Plant investment of all carriers, and in 1982, the implementation of ELG for Central Office Equipment. The group would determine a plan for the development of individual reserve accounts for AT&T companies so that their remaining life rates can be implemented. Finally, the group must address the resolution and implementation of the blanket filings for terminal equipment presently held by the carriers. These issues are of extreme urgency since technological and competitive changes allow very little time for recovery of the past deferred dollars of investment. The group must report its findings and recommendations to the Commission no later than December 1, 1981, in order for the Commission to adopt the necessary prescription orders prior to December 31, 1981.

The Cost Recovery Group should be constituted no later than September 1981, and should immediately establish deadlines for the carriers to present their proposals for implementation of Reserve Allocations, Remaining Life Rates, Equal Life Group rates and practices, and resolution of related problems. The Group should also immediately determine, announce, and adhere to a timetable for the accomplishment of these objectives.

I believe that this proposal will give the Commission the best opportunity to maintain the timetable for the implementation of capital recovery and thereby ensure the integrity of its competitive policies. I am recommending that this proposal be adopted by the full Commission.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

CC Docket 79-105

In the Matter of

Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies, of the Commission's Rules and Regulations with respect to accounting for station connections, optional payment plan revenues and related capital costs, customer provided equipment and sale of terminal equipment.

PETITION FOR RECONSIDERATION

(Filed June 7, 1982)

Pursuant to Section 1.429 of the Commission's Rules, American Telephone and Telegraph Company, for itself and on behalf of the associated Bell System Operating Companies (hereinafter "Bell Companies"), respectfully requests that the Commission reconsider its *Memorandum Opinion and Order*, released April 27, 1982 (April 27 Order).[1]

I. *Preliminary Statement*

1. In its April 27 Order, the Commission found that, for intrastate ratemaking, states are *not* bound to follow rules prescribed by the Commission that require carriers to treat certain station connection costs as expenses rather than as a capital investment in plant. This action represents a withdrawal on the Commission's part of support for its cost causative ratemaking policy clearly enunciated in Docket 19129, Phase II (64 F.C.C. 2d 1 (1977)), and its *First Report and Order* herein (85 F.C.C. 2d 818 (1981) (First Report and Order)). In addition, the April 27 Order is based upon errors in fact and law.

[1] The Order was published in the Federal Register on May 5, 1982. 47 Fed. Reg. 19361 (1982).

2. In the short time since the April 27 Order was released, parties have already begun to interpret it broadly as meaning that the Commission no longer intends to support its national policies, particularly those promoting competition throughout the telecommunications industry, with the necessary depreciation (capital recovery) programs essential to the realization of such policies. However, for these competitive policies to be viable, carriers must be permitted and encouraged to recover their capital fully and in a timely fashion.

3. Even before the April 27 Order was adopted, the commissions of some states had stated that they did not intend to follow Commission prescribed depreciation.[2] More recently, the April 27 Order has been cited as relieving state commissions from any obligation to follow any depreciation method or rate prescribed by this Commission. Some parties have even cited the April 27 Order as indicating approval of state deviation from Commission-prescribed depreciation.[3]

4. The Bell Companies have been moving affirmatively in seeking timely Commission prescription of realistic depreciation rates. The use of those rates is central to the promotion of a broad range of Commission policies. Specifically, proper depreciation rates are essential to permit pricing decisions to be based on the true costs of service, thereby avoiding artificial barriers to compe-

[2] For example, General Orders adopted by the Alabama, Louisiana, and Nebraska Commissions each contained the following language: "Depreciation rates for . . . all . . . equipment historically regulated in the intrastate jurisdiction, will be set according to policies approved by this Commission. They will not be established to further a policy of 'deregulation' of the FCC." *Reaffirmation of the Applicability of State Regulatory Principles*, General Order, p. 3 (Neb. PSC, August 24, 1981); *Reaffirmation of the Applicability of State Regulatory Principles*, General Order, p. 4 (Ala. PSC, July 17, 1981); *Reaffirmation of the Applicability of State Regulatory Principles*, General Order, p. 4 (La. PSC, June 30, 1981).

[3] *See* Paras. 32-37. *infra*.

tition.[4] Moreover, adequate capital recovery will itself foster technological innovation which will directly enhance the efficiency of the communications network and will also expand the scope and extent of competitive alternatives.[5] In addition, the attainment of appropriate depreciation reserves will facilitate the timely implementation of the detariffing of customer premises equipment which the Commission has found necessary to accommodate changing technology and growing competitive markets.[6]

5. However, if state commissions are free to deviate from Commission prescribed depreciation for intrastate ratemaking and to deny the Companies the revenues needed to cover realistic depreciation, the beneficial effects of sound capital recovery will not be realized, thereby frustrating the Commission's policies. Thus, the Commission should find that, as a matter of policy under Sections 1 and 2 of the Communications Act of 1934 (Act),[7] states are bound to follow the Commission's prescription of depreciation practices and rates for intrastate ratemaking so as to avoid frustration of its policies. The Commission's nationwide policies must be accompanied by a uniform nationwide policy of capital recovery.

6. Moreover, the Commission, in promulgating expensing rules, was, in effect, prescribing classes of depreciable property and depreciation rates. As a matter of law, such action is preemptive on the States for all regulatory purposes by virtue of Section 220(b) of the Act.[8] For this reason alone, the Commission should reconsider its April 27 Order and find that states are required to follow the expensing rules for intrastate ratemaking.

7. Because there is an urgent need for the Commission to reaffirm the importance of capital recovery and exercise its statutory duty to preempt depreciation, both as a matter of law

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[4] *See* Paras. 23-26. *infra*.

[5] *See* Paras. 20-22, *infra*.

[6] *See* Paras. 28-31, *infra*.

[7] 47 U.S.C. § 151-2.

[8] 47 U.S.C. § 220.

and as support for national policies, the Bell Companies believe that the Commission should give this Petition expedited consideration.

II. *Uniformly Applied Depreciation Is Essential To The Protection And Promotion Of Commission Policies*

8. The First report and Order in this proceeding, dated March 31, 1981, was a depreciation order and the expensing rules for station connections promulgated therein necessarily involve broader capital recovery issues.[9] For this reason, the preemptive effect of the First Report and Order, as clarified in the April 27 Order, must be reconsidered in light of the impact of depreciation matters generally on Commission policies.

9. As demonstrated below, Commission prescribed depreciation rates and methods play a central role in the effectuation of a broad range of Commission policies. The Commission should therefore take action to ensure that its prescribed depreciation, including the depreciation aspects of its expensing rules, is followed by all states.

A. *Timely And Effective Capital Recovery Is Essential To National Telecommunications Objectives.*

10. Telecommunications is a capital intensive industry. For example, the Bell System has invested about $2.00 in telephone plant for each $1,00 of annual revenues.[10] All carriers must

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[9] In its First Report and Order, the Commission removed new inside wiring costs from the classes of depreciable property. It also adopted amortization rules for embedded inside wiring which amounted to a prescription of depreciation rates. These were actions taken under Section 220(b) of the Act, which provides for classifications of depreciable property and the prescription of depreciation rates.

[10] The Bell System is much more capital intensive than the average company, about four times as capital intensive as the fifty largest manufacturing companies, as measured by the investment to revenues ratio. The investment to revenues ratios of some of the Bell Companies' emerging competitors are: General Dynamics, 0.35; IBM, 0.75; ITT, 0.59; and Motorola, 0.52. (These data are for the 1980-81 period.)

recover their capital fully and in a timely fashion in order to remain viable providers of telecommunications services. The recovery of invested capital, therefore, is a fundamental part of carrying out the Commission's statutory responsibility to make available a rapid, efficient, nationwide communications service. The Commission has recognized its responsibility by providing recent changes to depreciation methods and rates.

11. The Commission has recognized that the use of appropriate depreciation is important to the financial viability of the carriers. It has stated that "distortion of the measure of depreciation would in turn lead to a misstatement of the results of operations for the period and would also misstate . . . its balance sheet. [S]uch distortions [could be] deemed to be deleterious to the safety and recovery of . . . investment, [and investors] would likely demand a higher return on their funds."[11]

12. The Commission has also found that its capital recovery reforms generally "will further the mandate of Section 1 of the Communications Act, 'to make available, so far as possible, to all people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communications service with adequate facilities at reasonable charges. . . .' "[12]

13. However, depreciation only becomes capital recovery when it is fully and timely recovered through revenues authorized by the Commission and by state regulators. As recognized by the Financial Accounting Standards Board: "Unless an accounting order indicates the way a cost will be handled for rate-making purposes, it causes no enonomic effects . . . . The mere issuance of an accounting order not tied to rate treatment does not change an enterprise's economic resources or obligations."[13]

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[11] *Property Depreciation*, 83 F.C.C.2d 267, 272 (1980) (Docket 20188).

[12] *Id.* at 293, quoting 47 U.S.C. § 151.

[13] Financial Accounting Standards Board, *Accounting for the Effects of Regulation Of An Enterprise's Prices Based On Its Costs*, p. 21 (March 4, 1982) (exposure draft).

14. Jurisdictional separations assigns approximately 75% of depreciation expense resulting from Commission prescribed depreciation methods and rates to state regulatory jurisdictions. Unless intrastate rates are set to recover this 75% of depreciation expense, carriers will be denied the capital recovery determined by the Commission to be necessary and appropriate for a rapid, efficient nationwide communications service.

15. For these reasons, the establishment of depreciation methods and the prescription rates must be inseparable from ratemaking. The state commissions must use the depreciation rates prescribed by the Commission in determining intrastate revenue requirements. Otherwise, the impact of the spectrum of regulatory decisions bearing on national objectives—cost allocation, pricing, innovation and new technology, accurate representation of financial results, and internal funds generation—will be frustrated.

B. *The Commission Has Determined That Fostering Competition Is the Best Approach To Achieve Its Objectives*

16. In addition to adopting capital recovery reforms to further the mandate of Section 1 of the Act, the Commission has adopted a policy of promoting competition for telecommunications services as the means of carrying out the same statutory objective. It has repeatedly found that competition stimulates innovation thereby affording customers a wider range of services to meet their needs at lower cost.[14] The Commission has also found that competition results in "improved installation features including ease of making changes, competitive sources of supply, the option of leasing or owning equipment, and competitive pricing and payment options."[15] Thus, fostering competition has become the foundation of national telecommunications policy.

17. Competition and depreciation are inextricably tied together. Uniformly applied and properly determined depreciation

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[14] *Second Computer Inquiry*, 77 F.C.C.2d 384, 439 (1980); *see also*, *Competitive Carrier Rulemaking*, 85 F.C.C.2d 1, 14 (1980).

[15] *Second Computer Inquiry*, 77 F.C.C.2d at 439 (citations and footnotes omitted).

rates are essential to the Commission's policy of promoting competition. At the same time, the growth of competition dramatically changes depreciation requirements. Some of these interactive effects are discussed below.

1. *Impact Of Competition On Service Lives And Depreciation Methods*

18. The transition from a monopoly to a competitive environment has been one of the primary factors in changing service lives and, thus, the rates of capital consumption of communications plant. As competition increases, obsolesence becomes a more important factor in retirements, making service lives shorter than they were in a monopoly environment. Depreciation rates must be changed to reflect these shorter lives. Furthermore, because the Commission's policy of fostering competition was not anticipated in past depreciation rates, a change in depreciation methodology from whole life to remaining life is necessary.[16]

19. In light of these facts, the Commission has properly approved the use of more realistic service lives and remaining life depreciation. However, the Commission's actions will be ineffective unless state commissions follow Commission prescribed depreciation. The Commission, which has set that level of competition, must be responsible for setting the level of capital consumption to be recorded on the carrier's books and to be used for ratemaking purposes, both interstate and intrastate. It would be error for the Commission to leave the setting of depreciation rates used for ratemaking to state commissions which may disagree with federal policies and may wish to discourage their implementation or at least ignore their impact.

2. *The Promotion Of Innovation*

20. The Commission has stated that using equal life group depreciation (ELG) for prospective investments is necessary "[i]f the public is to realize the benefits of advances in communication" because ELG will encourage "innovation and . . . the

[16] *Property Depreciation*, 83 F.C.C.2d at 290.

introduction of new technology."[17] The Commission further noted that the use of remaining life depreciation is just as necessary for embedded plant.[18] The same reasoning applies to the use of more realistic service lives reflecting the impact of current technology and competition.

21. Thus, the depreciation methods adopted by the Commission are key factors in encouraging innovation and the introduction of new technology. Innovation and technology, in turn, are key factors in fostering competition. As the Commission has noted, advances in large scale integrated circuitry and microprocessor technology have broadened the areas subject to competition and have opened up new, competitive markets.[19] Moreover, technology advances have reduced scale economies as a barrier to entry in many telecommunications fields.[20]

22. It can safely be said that the level of competition today could not exist without the technological developments of the last 15 years. If the Commission is to be successful in fostering competition in the future, it must insure that its prescribed depreciation will be followed in both inter- and intrastate ratemaking; otherwise the innovation necessary for continued competitive growth will be stifled.

3. *The Impact of Depreciation On Pricing*

23. Depreciation is also a principal ingredient underlying pricing decisions for carriers. The Commission has unequivocally recognized this fact:

> "Measures of costs under depreciation accounting . . . are of the utmost importance and should be as accurate as circumstances will allow. The accounting measures of costs and

[17] *Id.* at 281.

[18] *Id.* at 290, 293-94.

[19] *See, e.g., Second Computer Inquiry*, 77 F.C.C.2d at 391 & 427.

[20] *See, e.g., id.* at 412.

revenues are the information base upon which pricing and ratemaking decisions are predicated."[21]

Pricing decisions in turn have a direct impact on the viability of competition. Firms in a competitive market, including regulated firms, must base their prices on costs.

24. It is not enough that pricing decisions are based on costs; the costs must be accurately stated. Rejection by state commissions of ELG depreciation, remaining life depreciation, and the use of more realistic service lives would misstate the costs of service used for pricing (ratemaking). It would understate the costs of services today by understating the current rate of capital consumption.[22] It would also overstate costs of services in the future, due to a growing base of underdepreciated plant. As a result, future customers would be required to subsidize current customers.[23] This intertemporal subsidy would send false price signals to the marketplace and would artifically inhibit competition.

25. Station connections provides a specific example of this concern. The Commission adopted its depreciation and accounting rules for inside wiring to further the "principle that the causative ratepayer should bear the full burden of the costs of station connections.[24] The Commission expressly stated that it wanted to avoid intertemporal subsidies for station connections.[25] Even though the Commission recognized that full cost causative pricing could not be assured with depreciation and accounting rules alone, it found that, without such rules, the embedded investment in inside wiring would continue to grow and there would be no way to avoid a continued shifting of costs caused by current customers to future customers. It therefore held that inside wiring should no longer be classified as depreciable property and that the depreciation methodology for the embedded investment in inside wiring should be based on a ten year amortization.

26. However, the only way to stop the placing of new inside wiring costs on future ratepayers is by state adherence to these depreciation related rules. Otherwise, if states are free to ignore the Commission's rules for inside wiring, its policy objectives will be frustrated because about 75% of inside wiring costs are assigned to intrastate operations.

4. *The Impact of Unrecovered Investment on Existing Carriers*

27. The Commission has recognized the need for existing carriers to be an intergral part of the growing competitive telecommunications markets on a continuing basis. Existing carriers are a vital link in the ongoing transition from a monopoly to a competitive environment. However, those carriers have made large investments in plant in line with past Commission policies. If the carriers are to make the transition to serving competitive markets, those investments must now be recovered in line with present Commission policies. Otherwise, the carriers' financial integrity will be impaired, ultimately raising costs of service and precluding the carriers' effective participation in an industry more and more characterized by free entry, lowered investment, and reduced capital carrying charges.

C. *The Full And Effective Implementation Of The Second Computer Inquiry Requires A Consistent Approach To Depreciation*

28. In the *Second Computer Inquiry* and related proceedings, the Commission has determined that detariffing customer premises equipment (CPE) and enhanced services is required to effect its pro-competitive policies[26] and that a full and timely implementation of detariffing will require some disposition of embedded

[21] *Property Depreciation*, 83 F.C.C.2d at 272.

[22] *See, e.g., Property Depreciation*, 83 F.C.C.2d at 293.

[23] *See, e.g., id.* at 268.

[24] *AT&T*, 64 F.C.C.2d 1, 55.

[25] *E.g., Deregulation of Inside Wiring*, 86 F.C.C.2d 885 (1981).

[26] *See, e.g., Second Computer Inquiry*, 77 F.C.C.2d at 427.

customer premises equipment.[27] Implementing detariffing will be difficult, although the use of sound depreciation will lessen those difficulties. For example, the Commission stated that "the remaining life rates [prescribed January 21, 1982] will . . . reduce the amount of any underdepreciation for 'embedded' CPE which may now exist and will facilitate the sale, transfer or other disposition of that CPE."[28]

29. Conversely, the failure of state commissions to use remaining life and other Commission prescribed depreciation will increase underdepreciation and interfere with the sale, transfer or other disposition of that CPE. The potential problem is substantial. The Commission has prescribed depreciation rates that increased annual depreciation expense for terminal equipment in the Bell System by about $800 million in 1981. Increased depreciation expense can be expected in the future. Thus, the rejection of Commission prescribed depreciation rates by even a few state commissions would result in a substantial reduction of capital recovery for the Bell Companies alone.[29]

30. This reduction of capital recovery would interfere with the disposition of assets contemplated under full implementation of the *Second Computer Inquiry*. When assets are disposed of by a common carrier, value is determined by netting the accumulated

[27] *See, Procedures For Implementing The Detariffing Of Customer Premises Equipment And Enhanced Services (Second Computer Inquiry)*, Notice of Inquiry, CC Docket No. 81-893 (April 13, 1982).

[28] *Id.* Para. 5.

[29] Parties to state rate cases are urging state commissions to adopt depreciation rates lower than those prescribed by the FCC on the ground that capital recovery should not be a concern of the state commission since the assets, upon disposition, will be removed from state commission jurisdiction. *See, e.g., Pa. P.U.C. v. The Bell Telephone Co. of Pa.*, Testimony of Paul F. Levy, pp. 3-4, Pa. P.U.C. Dkt. R-811819 (filed April 9, 1982) (Economics and Technology witness) (hereinafter "Levy Testimony"); *id.*, Testimony of Jamshed K. Madan, pp. 9-10 (filed April 10, 1092) (Georgetown Consulting Group witness). The firms submitting this testimony participate in state rate cases throughout the country and frequently serve as state commission consultants.

depreciation against the gross original cost of the asset (*i.e.*, net book value).[30] The accumulated depreciation is the sum of annual depreciation charges. So long as state commissions use for intrastate ratemaking the Commission prescribed depreciation rates, book value is an undisputed amount. However, where the state commission uses a lower depreciation rate, the accumulated depreciation maintained to satisfy state commission requirements will be different from the accumulated depreciation recorded in the Uniform System of Accounts. The result is a disputed book value; the Commission prescribed value is less than the state commission value because the accumulated depreciation is greater. To complicate matters further, the portion of plant to which either book value could apply would shift over time with the changing allocation of plant to the interstate jurisdiction under the separations process.

31. State commissions and other parties can be expected to want to provide an input into any asset disposition process that may be instituted under the *Second Computer Inquiry*.[31] Without Commission preemption of depreciation, the resulting differences of opinion as to the book value of the transferred assets resulting from the use of non-uniform depreciation rates would complicate and delay the process.

III. *Preemption of the States with Regard to Depreciation is Necessary to Commission Policies*

32. As described above, state commission adherence to Commission prescribed depreciation in intrastate ratemaking is essential to avoid frustration of a broad range of Commission policies. It is not enough to assume that state commissions will go along with Commission prescribed depreciation without direction from

[30] Adjusted net book value would include tax and other impacts to reflect the net regulated value of the asset.

[31] The suggestion is being made before state commissions that the capital consumption accounted for by them in setting intrastate rates should be controlling in that process. *See, e.g.*, Levy Testimony, *supra*, at pp. 3-4, 24-26.

the Commission. Although it is true that state commissions have followed Commission depreciation in the past almost without exception, the current changes in the industry and the implications for capital recovery are more severe than at any time since the Commission was established. Therefore, history cannot be a guide to the future.

33. There are clear signs that a substantial number of states will now deviate from Commission prescribed depreciation. In the first place, a number of state commissions disagree with this Commission's pro-competitive policy. Already, three state commissions have stated they intend to deviate from Commission prescribed depreciation rates expressly so as to interfere with the implementation of this Commission's pro-competitive policies, with which they disagree.[32] A number of other state commissions have denied the use of remaining life or ELG depreciation without being so specific as to their reasons.[33]

34. Futhermore, some state commissions, while not necessarily disagreeing with Commission policies, may feel that specific depreciation methods, necessary to promote those policies, are not consistent with their regulatory views. For example, the Ohio Commission recently rejected the use of remaining life depreciation on the ground that it was contrary to that Commission's regulatory policies under Ohio law.[34]

35. Finally, in the short time since it was issued, the Commission's April 27 Order itself is already being broadly interpreted by various parties as relieving state commissions from any obligation to follow any depreciation method or rate prescribed by the Commission. Some parties have even cited the April 27 order as

[32] *See* p. 2, n.2, *supra*.

[33] *See, e.g., Application of Mountain States Tel. & Tel. Co.*, Idaho P.U.C. Case No. U-1000-55 (March 1, 1982); *Southern Bell Tel. & Tel. Co.*, S.C. P.S.C. Dkt. No. 81-201-C (Jan. 8, 1982).

[34] *Ohio Bell Telephone Co.*, Case No. 80-1010-TP-AAM, pp. 29-31 (Ohio PSC, April 21, 1982). The Ohio Commission did not decide the preemption question, finding that it did not have the authority to do so under Ohio law. *Id*, at 28-29.

indicating approval of state deviation from Commission-prescribed depreciation.

36. For example, the New Jersey Division of Rate Counsel recently submitted testimony recommending rejection of remaining life depreciation and citing the Commission's decision in its April 27 Order for the proposition "that the FCC will accept the disallowance."[35] At oral argument in a proceeding before the Michigan Public Service Commission, Staff Counsel referred to the April 27 Order in support of his assertion that this Commission had no jurisdiction to determine the depreciation rates and methods used for intrastate ratemaking.[36] At the recent three-way represcription meeting for New England Telephone, one of the state commission staff members, referring to the decision in the April 27 Order, stated that the depreciation rates to be used for ratemaking purposes would be determined by the state commissions irrespective of the findings of this Commission.

37. Thus, the Commission must preempt the states in depreciation matters to ensure that its prescribed depreciation will be followed by the states, as is necessary for the furtherance of Commission policies. As demonstrated below, the Commission has the legal authority to so preempt the states and the obligation to exercise that authority.

IV. *The Commission Has The Authority And The Obligation To Preempt The States As To Depreciation*

38. Because preemption of depreciation matters is essential to the Commission's policies, the Commission has the authority and duty under both Section 2 and Section 220(b) of the Communications Act to preempt the states as to depreciation generally and specifically as to the classification and depreciation of station

[35] *Application of New Jersey Bell Telephone Company*, Testimony of Charles W. King, p. 5, N.J. BPU Docket No. 815-458 (filed April 1982).

[36] *Review of Michigan Bell Telephone Company For Revision of its Depreciation Rates*, Tr. 28, Mich. PSC Case No. U-6388 (May 14, 1982 Oral Argument).

connections. The Commission should make preemption clear to all parties.

A. *The Commission's Power To Preempt Under Section 2 Is Applicable In This Case.*

39. The Commission found in its April 27 Order that the Communications Act, and specifically Section 2(b), "does not prohibit preemption of state regulatory actions that might interfere with or tend to frustrate policies or rules [the Commission has] adopted to carry out statutory objectives with respect to interstate and foreign communications."[37] The courts have stated the limitations of Section 2(b) even more strongly.

40. For example, the Fourth Circuit has held that Section 2(b) applies only to facilities "separable from and . . . not substantially affect[ing] the conduct or development of interstate communications."[38] The Commission has jurisdiction under Section 2(a) over all other plant. The District of Columbia Circuit has cited the Fourth Circuit decision with approval, declaring that "the Commission . . . may regulate facilities used in both inter- and intra-state communications" to the extent the unified regulation is needed.[39]

41. Moreover, where there may be interference with or a tendency to frustrate Commission rules and policies adopted to carry out its statutory objectives, preemption of state action is necessarily implied. The Supreme Court has held that this Commission has jurisdiction "not merely to protect but to promote [its

[37] April 27 Order, Para. 37.

[38] *North Carolina Utilities Commission v. FCC*, 552 F.2d 1036, 1046 (4th Cir.) *cert deneid* 434 U.S. 874 (1977) (hereinafter NCUC II) quoting *North Carolina Utilities Commission v. FCC*, 537 F.2d 787, 793 (4th Cir.) *cert deneid* 429 U.S. 1027 (1976).

[39] *California v. FCC*, 567 F.2d 84, 86 (1977), *cert. denied*, 434 U.S. 1010 (1978). In even stronger language, Judge Wright has stated that: "To the extent the . . . services . . . involve or may involve interstate communications, Section [2(b)] is clearly inapplicable." *National Association of Regulatory Utility Commissioners v. FCC*, 533 F.2d 601, 634 (D.C. 1976) (Wright, J., dissenting).

statutory] objectives."[40] And it has been expressly held that "FCC regulation *must preempt* any contrary state regulations where the efficiency or safety of the national communications network is at stake."[41]

42. Because of the central role that depreciation, including the depreciation aspects of expensing station connections, plays in the effectuation of Commission policies, preemption is necessary to avoid interference with or frustration of commission policies. To hold otherwise would require reversal of the Commission's findings in Docket 20188, the First Report and Order in Docket 79-105, and the Second Computer Inquiry. Thus, the Commission must find that its prescription of depreciation methods and rates preempts the states.

B. *The Commission Erred In Its Order By Not Preempting Under Section 220(b)*

43. In addition to the reasons for preemption set forth in Paragraphs 39-42 *supra*, the Commission should reconsider its April 27 Order because of the specific errors of law and fact in the April 27 Order which, in themselves, are grounds for reconsideration.

1. *The Commission Has Erred By Ignoring The Provisions Of Section 220(b)*

44. The Commission in its April 27 Order, Part II,[42] assumes, that "AT&T . . . relies primarily upon Subsection 220(g) . . . ." To the contrary, the crux of this case is that the Commission, by adopting rules for the expensing station connections in the First Report and Order, acted pursuant to Section 220(b) of the Act by which Congress granted it exclusive power to prescribe classes of depreciable property and depreciation rates.

45. While the Commission has the statutory flexibility under Section 220(g) to permit deviations from its *accounting* rules,

[40] *United States v. Midwest Video Corp.*, 406 U.S. 649, 667 (1972).

[41] *NCUC II*, 552 F.2d at 1046 (emphasis added).

[42] April 27 Order, Paras. 9-37.

there is no statutory provision which permits any deviation from classification of depreciable property and prescription of *depreciation* under Section 220(b). Because the Commission's First Report and Order classified property and prescribed depreciation rates under Section 220(b), carriers and state commissions are obliged to follow these rules for intrastate ratemaking.

46. Section 220 permits flexibility in respect of accounting rules promulgated by the Commission. Section 220(a) of the Act provides that "[t]he Commission may, *in its discretion,* prescribe the forms of any and all accounts, records, and memoranda," as distinguished from the mandatory requirements of Section 220(b). Once the Commission prescribes accounting rules, carriers must maintain their regulatory books of accounts in accordance with such rules pursuant to Section 220(g) of the Act, which states in pertinent part: "it shall be unlawful for [any carrier] to keep any other accounts, records, or memoranda than those so prescribed *or such as may be approved by the Commission"* (emphasis added).

47. Section 220(g) thus permits carriers to keep accounts other than those prescribed by the Commission if they are "such as may be approved by the Commission." The Commission in fact has approved variations from its prescribed Uniform System of Accounts. For example, Section 31.01-2(f) of its Rules gives states "blanket" authority to subdivide prescribed accounts for this purpose.[43] Another variation cited in the Commission's Order deals with plant under construction (April 27 Order, Para. 32). There, the Commission expressly approved state commission ratemaking treatment of plant under construction different from that adopted by the Commission. The necessary implication of

[43] *See* April 27 Order, Para. 18, n.10. The Commission's reliance on this provision is misplaced in this case. That provision allows states only to subdivide primary accounts (*e.g.,* to subdivide a capital account like central office equipment into various categories of capitalized central office equipment). It does not mean that where the USOA requires a transaction to be expensed, a state can require the carrier to capitalize that same transaction. This would be the result if a state required a carrier to capitalize a station connection cost for which the Commission requires expensing.

this action is that the accounts, records, and memoranda required to implement a different ratemaking treatment for that plant would be "such as may be approved by the Commission" and would therefore be permissible under Section 220(g). These examples illustrate the flexibility provided by Section 220(g).[44] They do not support the Commission's mistaken finding that Section 220 has no binding effect on the states whatsoever. For, as shown below, Section 220(b) requires adherence to Commission prescribed depreciation rates.

2. *The Provisions of Section 220(b) Mandate Preemption*

48. Section 220(b) of the Communications Act grants the Commission *exclusive* power to prescribe depreciable classes of property and depreciation rates of carriers under its jurisdiction. It provides:

> (b) The Commission *shall,* as soon as practicable, *prescribe* for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which *shall* be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers *shall not,* after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to *any* class of property a percentage of depreciation *other than* that prescribed therefor by the Commission. No such carrier shall *in any case* include in any form under its operating or other

[44] The Commission cited these examples as illustrating "forty years of administrative practice" which would be repudiated by preemption. (April 27 Order, Para. 34.) However, since these practices would still be permissable under Section 220(g), they would not be repudiated. Moreover, no administrative practice can change the Commission's statutorily imposed obligations under the law.

expenses *any* depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise un[illegible] its operating or other expenses. (emphasis added)

49. In the plain language of Section 220(b), the Commission has preemptive regulatory authority over matters of depreciation. The language Congress chose was express and unequivocal: that the Commission "shall . . . prescribe" for carriers subject to its jurisdiction "classes of property for which depreciation charges may be properly included under operating expenses," and the "percentages of depreciation which shall be charged to . . . such classes."

50. Moreover, after Commission prescription, such carriers "shall not" charge any depreciation on "classes of property" not classified by the Commission as depreciable, and the carriers shall not charge in any case "a percentage of depreciation" "other than that prescribed by the Commission."[45]

51. Thus, Section 220(b) requires that depreciation prescribed by the Commission is binding for all purposes. In its First Report and Order, the Commission acted under Section 220(b) and thereby bound the states.

3. *The Legislative History of Section 220(b) Supports Mandatory Preemption*

52. The Commission has erred in apparently concluding that depreciation it prescribes pursuant to Section 220(b) is not binding on states for intrastate ratemaking.[46] The Commission's

[45] It is fundamental to statutory construction that where the statutory "language is clear and unambiguous it must be held to mean what it plainly expresses." Sutherland, *Statutory Construction*, Section 46.01, Fourth Edition, 1973. Also, see Association of American Railroads v. Costle, 562 F.2d 1310 (D.C. Cir. 1977), which holds that "[t]he word 'shall' is the language of command in a statute. . . ." (at p. 1312).

[46] "Apparently" is used here in the sense that while the thrust of the Order is directed at Sections 220(a) and 220(g) of the Act, the Commission appears to sweep into its conclusion that matters of depreciation prescribed under Section 220(b) are likewise not binding on the states.

apparent conclusion is in part premised upon a misreading of the legislative history of Section 220.

53. The Interstate Commerce Commission (ICC), acting under the Section 20(5) of the ICC Act, which was recodified in the Communications Act as Section 220(b), correctly interpreted its powers regarding depreciation as plenary. In *Depreciation Charges of Telephone Companies*, the ICC rejected the view that Section 20(5) could not properly apply to plant jointly used for inter- and intrastate service.[47]

> "It seems to be well established that where a local telephone company undertakes to originate or deliver toll messages, and most of them do so undertake, practically all of its property is open for use in interstate commerce and at any time may be so used. Under such circumstances, no doubt would seem to exist as to the power of Congress to regulate the accounting practices of such companies with respect to their property, including the accounting for depreciation."[48]

54. Therefore, it is not surprising that when Congress was considering the Communications Act of 1934, the states promoted the original version of Section 220. That version, in Section 220(j), would have expressly permitted state commissions to prescribe depreciation rates for purposes of exercising their jurisdiction over telephone companies, but Congress ultimately dropped this provision in favor of merely having the Commission report on the desirability of further legislation in this area. During hearings on the bill in each House of Congress, state commissions, through the National Association of Railroad and Utility Commissioners ("NARUC"), vigorously argued that such an express provision was necessary for states not to be bound in intrastate rate cases by Commission prescribed depreciation rates.

55. Notwithstanding the evidence to the contrary, the Commission erroneously concludes in its April 27 Order that the legislative history of the Communications Act does not indicate

[47] Virtually all of the Bell Companies' plant is so used.

[48] *Depreciation Charges of Telephone Companies*, 118 I.C.C. 295, 332 (1926).

an intent on Congress' part to give the Commission preemptive authority over depreciation.

56. The Commission relies heavily on the statements made by witnesses at legislative hearings to support its contention that the original language of Section 220(j), which would have expressly precluded preemption, was proposed only to clarify prior law.[49] However, the Commission ignores the language incorporated into the various committee reports, namely: (1) the statement in the House Report that the original Section 220(j) language was "responsive to the requests of State commissions *that the present law be changed so as to permit* those bodies to exercise, for State purposes, certain jurisdiction over . . . depreciation";[50] and (2) the statement in the Senate Report that the Senate version of Section 220(j), similar to that enacted, "calls for investigation and report to Congress *instead of* immediately turning over these matters to the State."[51]

57. Moreover, the Commission mischaracterizes the testimony of the witnesses, stating: "Only one opposing witness [Mr. Gifford], however, specifically expressed the view that the then-current law [reenacted in Section 220(a)-(g)] prohibited the states from prescribing accounts and depreciation rates. . . ."[52] To the contrary, Mr. Benton, NARUC's general solicitor, testified in the Senate hearings:

> "Ever since Congress in 1920 empowered the Interstate Commerce Commission to prescribe rates of depreciation, the State commissions have believed it would work to their embarrassment and do the public injury. . . . They think it is a dangerous thing to have a Federal commission . . . fixing rates of depreciation. . . . It is dangerous, because if they are

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[49] April 27 Order, Paras. 21-29.

[50] H.R. Rep. No. 1850, 73rd Cong., 2d Sess. 6 (1934) (emphasis added).

[51] S. Rep. No. 781, 73rd Cong., 2d Sess. 5 (1934). (emphasis added).

[52] April 27 Order, Para. 26.

> fixed wrong, then . . . the State commission's hands are tied."[53]

The report of the Interstate Commerce Commission to the Senate Committee on Interstate Commerce stated:

> "Paragraph (j) . . . directly conflicts with . . . uniform depreciation accounting required by the preceding provisions of the section. *That is not true under present law.*"[54]

And, Dr. Irwin Stewart, Department of State, testified that Section 220(b) was "taken from the Interestate Commerce Act which [gave] to the Interstate Commerce Commission the right to . . . fix depreciation charges. . . . That is, *it takes away jurisdiction that the State may have had.*"[55]

58. By misinterpreting the ICC rulings under Section 20(5) of the ICC Act and by ignoring relevant parts of the legislative history, the Commission has erred in concluding that Section 220 of the Act does not preempt the states with respect to depreciation. Indeed, the Commission cannot lawfully permit states to deviate from its prescription of depreciation matters under Section 220(b) of the Act.

Conclusion

For the foregoing reasons, the Bell Companies request that the Commission reconsider its April 27 Order and find that, in accordance with Section 220(b), states are bound, for all regulatory purposes, to follow Commission orders prescribing depreciation classifications, methods, and rates and to follow its First Report and Order as it pertains to expensing station connection costs specifically, and to depreciation matters generally. In the alternative, the Bell Companies request that the Commission, in

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[53] Hearings on S. 2910 Before Committee on Interstate Commerce, 73rd Cong., 2d Sess., p. 181 (1934) (Benton statement).

[54] *Id.* at 208 (emphasis added).

[55] Hearings on H.R. 8301 Before Committee on Interstate and Foreign Commerce, 73rd Cong., 2d Sess., p. 17 (1934) (statement of Irwin Stewart) (emphasis added).

accordance with its powers under Sections 1 and 2 of that Act, preempt depreciation matters for all intrastate regulatory purposes so as to avoid interference with or frustration of its policies.

Respectfully submitted,

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Before the
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

FILE NO.:
DOCKET NO.:

IN THE MATTER OF:

PETITION FOR DECLARATORY RULING ON QUESTION OF FEDERAL PREEMPTION INVOLVING ORDER OF THE PUBLIC UTILITIES COMMISSION OF OHIO IN CONFLICT WITH (I) FCC PRESCRIPTIONS UNDER SECTION 220 OF THE COMMUNICATIONS ACT AND (II) ESTABLISHED FCC POLICIES.

TO THE COMMISSION.

PETITION FOR DECLARATORY RULING
[Filed June 7, 1982]

General Telephone Company of Ohio ("General"), pursuant to Section 1.2 of the Commission's Rules, 47 CFR Section 1.2, and Section 5(e) of the Administrative Procedure Act, 5 U.S.C. 554(e), submits the following Petition for Declaratory Ruling:[1]

I. PARTIES

1. General is an Ohio corporation and a telephone company having its principal place of business at 100 Executive Drive, Marion, Ohio 43302. General provides telephone service in Ohio and Michigan, and is fully subject to the Communications Act of 1934 ("the Act"), 47 U.S.C. Section 151 et seq.

2. The Public Utilities Commission of Ohio ("PUCO") is the duly constituted state agency having jurisdiction with respect to the intrastate rates, charges, practices and procedures of

[1] General is also filing, as one of the GTE telephone companies, a petition in response to the Commission's Memorandum and Order released April 27, 1982, in CC Docket 79-105.

General. The offices of the PUCO are located at 375 South High Street, Columbus, Ohio 43215.

II. BACKGROUND

3. In accordance with this Commission's triennial depreciation represcription process, General was scheduled for review in 1981. On January 28, 1982, pursuant to § 220(b) of the Act, this Commission released its Order (FCC 82-40) prescribing revised percentages of depreciation for General, as well as other GTE companies. Depreciation accrual rates utilizing remaining life methodology, approved in Docket No. 20188,[2] were prescribed for all of General's plant accounts, effective December 1, 1981, except Account No. 232 which is effective October 1, 1981. Objections by the PUCO to the use of remaining life methodology and to the effective date were considered by this Commission and rejected.

4. On February 3, 1982, this Commission released its Order (FCC 82-53) modifying certain rates prescribed in its earlier Order so as to prescribe revised percentages of depreciation in accordance with the equal life group (ELG) methodology approved in Docket No. 20188. The ELG depreciation rates were prescribed effective January 1, 1982, applicable to future additions to outside plant for General and three other GTE telephone companies.

5. On April 26, 1982, the PUCO issued its Opinion and Order in Case Nos. 81-383-TP-AIR, 80-1124-TP-AAM and 81-354-TP-AAM, involving General's application to increase intrastate rates and charges and to change its depreciation accrual rates. The PUCO determined that it would not use the remaining life and/or the ELG depreciation rates prescribed by this Commission in determining the proper allowance for depreciation expense in General's rate case. The PUCO considered the merits of whole life and remaining life methodologies, and rejected the use of remaining life methodology and depreciation accrual rates. The PUCO prescribed new depreciation accrual rates based on the

[2] 83 FCC 2d 267 (1980); *Reconsideration*, 87 FCC 2d 916 (1981)

whole life method, and ordered that General apply the new whole life depreciation accrual rates to its intrastate plant commencing May 1, 1982, until the PUCO orders otherwise. Attached hereto as Exhibit A are pages 23-27 and 60 of the PUCO's Opinion and Order, involving the depreciation issues determined therein.

6. The April 26, 1982 Order of the PUCO prescribing whole life depreciation rates for General is in conflict with Orders of this Commission released January 28, 1982 (FCC 82-40) and February 3, 1982 (FCC 82-53). Attached hereto as Exhibit B is the schedule of remaining life depreciation accrual rates prescribed by this Commission for General. Attached hereto as Exhibit C is the schedule of equal life group depreciation accrual rates prescribed by this Commission for General. Attached hereto as Exhibit D is the schedule of whole life depreciation rates prescribed by the PUCO for General. The PUCO prescribed depreciation accrual rates are generally lower than the depreciation accrual rates prescribed by this Commission. Use of the remaining life and ELG depreciation accrual rates prescribed by this Commission would have resulted in approximately $7 million more depreciation expense and capital recovery in General's rate case than resulted from the use of the PUCO's whole life depreciation accrual rates.

III. THIS COMMISSION HAS ALREADY REJECTED THE PUCO'S POSITION AGAINST REMAINING LIFE METHODOLOGY

7. The PUCO participated in this Commission's three-way meeting procedure with respect to the prescription of depreciation rates for General. In addition, as shown by Appendices 1 and 2 to this Commission's Order released January 28, 1982, (FCC 82-40), the PUCO further emphasized its opposition to remaining life methodology in its comments in response to the public notices issued January 27, 1981, and October 30, 1981. The PUCO further strongly objected to the company's requested effective date of December 1, 1981. These objections were considered by this Commission in paragraphs 35 through 42 of its Order released January 28, 1982, (FCC 82-40), and were rejected.

8. In addition, in its Order released February 3, 1982 (FCC 82-53), the Commission rejected contentions by the Michigan and Florida Public Service Commissions that companies in those states may not implement ELG until the State Commission issues a further Order permitting the use of that methodology. This Commission stated:

> "We have allowed, even encouraged, the use of ELG in Docket No. 20188 and are prescribing ELG rates in this proceeding. No further action is necessary for General of Michigan or General of Florida to put ELG rates into effect, and, indeed they are bound to follow our prescription."[3]

IV. THE PUCO ORDER FRUSTRATES FCC POLICIES

9. By using lower depreciation accrual rates for intrastate ratemaking purposes than prescribed by this Commission, the PUCO frustrates important capital recovery objectives of this Commission. In Docket No. 20188 this Commission found that ELG will further the mandate of Section 1 of the Communications Act. The Commission recognized that ELG "is likely to result in an increase in the near term in revenue requirements" but stated its belief "that the relative size of the increment will be repaid many times over in future years as the ability of regulated telephone companies to continue to provide '... rapid, efficient ... communication service with adequate facilities at reasonable charges is enhanced.' " See 83 FCC 2d at 281. The PUCO Order provides for less depreciation expense and less capital recovery than determined necessary by this Commission.

10. This Commission has recognized that every method of depreciation is predicated upon estimates of prospective events, and there can be no assurance that these estimates will accord perfectly with actual events as they unfold years later. The

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[3] The Commission noted in footnote 2 that it did not decide the effect of prescribing those rates for intrastate ratemaking purposes, and that the question was under review in Docket CC 79-105. A petition addressed to the Commission's April 27, 1982 Memorandum and Order therein is being filed by the GTE telephone companies. See Note 1.

Commission determined that: "Equal life group adjustments will be handled by application of remaining-life adjustments in the setting of rates during the normal represcription process." See 83 FCC 2d at 286, paragraph 66. As noted in Docket 20188:

> "With respect to telecommunications investment, the impact of new technology and the transition from a monopoly to a competitive environment have led to an overall shortening of life estimates. If the currently estimated shorter lives had been known all along, then past depreciation rates would have been higher even under the timing pattern of SLVG, and current reserves would be higher. Absent a reversal of current trends and without corrective action, the amount of difference due to errors of life estimate will continue to grow, and upon ultimate retirement the reserve provisions will not be adequate. It is for this reason that the Commission makes the choice that it must regarding the charging of costs to current and future periods." 83 FCC 2d at 290.

The Commission then directed all subject carriers to maintain book reserves in sufficient detail to allow the determination of depreciation rates by the remaining-life technique, and stated: "It is our desire that these actions not be delayed and that the corrective measures of remaining-life rates be implemented as soon as practicable. 83 FCC 2d at 290. These important objectives of this Commission are directly challenged and frustrated by the PUCO's Order.

11. The use of different depreciation rates for the interstate portion of General's plant accounts than for the intrastate portion will not achieve one hundred percent capital recovery, except by sheer and remote chance, even if the "books" for each jurisdiction reflect full capital recovery. The reason for this is that jurisdictional allocation factors are continually changing. Attached hereto as Exhibit E is an analysis illustrating this fact. Moreover, in this situation there continues to exist a possibility of "stranded investment"—i.e., a residue of investment dollars remaining in rate base long after retirement of the related asset. In fact. "stranded investment" may remain in rate base in perpetuity if a remaining life adjustment is never made. In Docket No. 20188 this Com-

mission sought to avoid "stranded investment." See 83 FCC 2d at 288, 289.

12. Further, the use of different depreciation rates for ratemaking purposes as opposed to depreciation rates for book purposes or depreciation rates for financial reporting purposes, creates confusion and casts doubt upon the financial integrity of the company's books and records. The determination of the company's revenue requirement, and necessary rates, must be made on a basis consistent with the books and records of the company if the books and records are to present a true financial picture of the firm. This Commission emphasized this point in Docket 20188:

> "If depreciation policies or practices were to be determined solely with concern for the level of revenue requirements, the actual measure of depreciation might be misstated. Such distortion of the measure of depreciation would in turn lead to a misstatement of the results of operations for the period and would also misstate the relative position of the enterprise as shown by its balance sheet. If such distortions were perceived by present and potential investors and were deemed to be deleterious to the safety and recovery of their investment, they in turn would likely demand a higher return on their funds. Consequently, a failure to properly measure by understating these costs would, in the long run, probably be offset by higher costs of capital without any real avoidance of the ultimate need to provide full recovery for the capital." 83 FCC 2d at 272.

13. At the same time, the Commission made clear that its concern in Docket 20188 was not merely with reporting requirements, but with the underlying process of capital recovery. When numerous state commissions strenuously objected to industry proposals for FCC adoption of ELG on the ground that such action by the FCC would result in dramatic increases in intrastate rates, the Commission gave explicit consideration to this question, and rejected the arguments of the states with the following comments:

> "We do not find increased rates (for subscribers) inconsistent, *per se*, with our mandate under Section 1 of the Act. . . . We must balance the interests of all present and all future customers in the preservation of adequate facilities at reasonable charges. On balance, we find it not unreasonable that present ratepayers incur some additional expense in order to preserve the integrity of the investment and to assure the continued and longer term satisfaction of the requirements of our congressional mandate. The only alternative, continued deferral of both recognition of current costs and initiation of corrective measures to rectify any past unrecovered costs, will require much larger adjustments to be made at some future date." 83 FCC 2d at 293.

14. In Docket 20188, after seven years of study, the FCC established definite policies regarding depreciation, and depreciation-related matters, by a unanimous vote of the Commissioners. With respect to these questions, the Docket 20188 decision establishes the "statutory objectives", the "federal policies or rules", and the "important interests of national communication policy" as these phrases are used in paragraph 37 of the Commission's decision released April 27, 1982, in CC Docket 79-105, FCC 82-155. Under the principles there set forth, any state action, including "state ratemaking actions", must be reconcilable with the foregoing.

15. If state regulation is permitted to frustrate the Commission's "important interests of national communications policy" as to capital recovery, such action also will serve to frustrate the Commission's "important interests" as to deregulation. The one cannot be separarted from the other. In relation to CPE deregulation, the Commission has recognized this fact in Docket 20828:

> "[D]etariffing of CPE requires consideration not only of transition procedures, but also of separations implications, *depreciation rates, investment recovery,* asset valuation and transfer pricing." (84 FCC 2d at 68, emphasis added.)

16. Indeed, these are the very issues which delayed the Commission's originally intended deregulation date of March 1,

1982 for embedded CPE, and which required further consideration in a separate implementation proceeding, CC Docket 81-893:

> "In the implementation proceeding which we will initiate shortly, we will address issues of *capital recovery*[15] and asset valuation, alternative mechanisms by which transition to an unregulated CPE environment may be achieved, and the appropriate time period for removal of embedded CPE investment from separations and a carrier's rate base." (84 FCC 2d at 69, emphasis added.)

17. Further, in Footnote 15 to the language just quoted, the Commission stressed the interrelationship of the Commission's capital recovery policies and the Commission's CPE deregulation policies.

> "Represcription of depreciation rates for terminal equipment is expect to proceed on a parallel course, utilizing the existing processes. *We believe this course to be desirable because of the need to closely coordinate our represcription of depreciation rates for jointly-used plant with affected state commissions.* See 47 U.S.C. Sec. 220(i)." (84 FCC 2d at 69, emphasis added.)

18. The same linkage exists between the Commission's capital recovery policies and its competitive policies. This linkage is integral to the Commission's ability to carry forward its competitive policies for network services as well. For example, one of the significant issues in introducing competition in intercity telecommunications services is the possibility of intercity carrier bypass of local telephone exchange facilities, and the impact such bypass might have on the availability of exchange access revenues and revenue requirements for local exchange telephone services. Unless the Commission's capital recovery policies, established in Docket 20188, are given real effect in terms of actual capital recovery, the rate base in jointly-used network access plant, and its attendant carrying costs, will be significantly inflated, thereby imposing burdens on exchange access charges for all carriers and encouraging local network bypass by intercity carriers to the detriment of local exchange ratepayers.

19. The direct conflict between the PUCO's Order and the FCC's decision to issue prescriptions for General—overriding State Commission objections to remaining life and ELG—establishes the need for decisive action by this Commission asserting its power and responsibility under Section 220(b) of the Act to foreclose inconsistent state action.

V. THIS COMMISSION HAS THE AUTHORITY AND RESPONSIBILITY TO PREEMPT THE PUCO'S USE OF DEPRECIATION RATES OTHER THAN THOSE PRESCRIBED BY THIS COMMISSION

20. Under principles of constitutional law, there is unquestioned federal power under the Commerce Clause of the U. S. Constitution to regulate an activity which has a "substantial economic effect" upon interstate commerce. See *Rasmussen v. American Dairy Assoc.*, 472 F. 2d 517 (9th Cir. 1973), *cert. denied* 412 U. S. 950 (1973); *Katzenbach v. McClung*, 379 U. S. 294, 301-305 (1964); *Maryland v. Wirtz*, 392 U. S. 183[,] 196-197 (1968); and *Wickard v. Filburn*, 317 U. S. 111, 125-128 (1942). Congress, in the Communications Act, and the courts, in cases discussed below, have recognized the substantial economic effect of telephone service on interstate commerce.

21. Further, where there is a proper exercise of federal power, inconsistent state action will be preempted. The law does not permit state action which would constitute "an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." See *Hines v. Davidowitz*, 312 U. S. 52, 67 (1941); De Cana v. Bica, 424 U. S. 351, 363 (1976); *Florida Lime & Avocado Growers Inc. v. Paul*, 373 U. S. 132, 142 (1963).

22. It is established law that the jurisdictional provisions of the Act (47 U.S.C. §§151, 152 and 221(b) do not deprive the Commission of jurisdiction over the use of facilities that necessarily serve both interstate and intrastate communications. In fact, FCC jurisdiction is to be precluded *only* in the case of:

> "local services, facilities and disputes that in their nature and effect are *separable from and do not substantially affect the*

conduct or *development* of interstate communications." (Emphasis added.)

North Carolina Util. Comm'n v. FCC, 537 F. 2d 787, 793-794 (4th Cir. 1976), *cert. denied* 429 U. S. 1027 (1976) (*North Carolina I*).

The Fourth Circuit provided further clarification in *North Carolina Util. Comm'n v. FCC*, 552 F. 2d 1036, 1044-1050 (4th Cir. 1977), *cert. denied* 434 U. S. 874 (1977) (North Carolina II), where the *North Carolina I* principles were approved and expanded:

"*North Carolina I* correctly reasoned that if section 2(b) (1) [47 U.S.C. § 152(b) (1)] were construed to give the states primary authority over joint terminal equipment, *i.e.* equipment used interchangeably for interstate and intrastate service, then—whenever state regulations conflicted with federal rules applicable to interstate calls—the FCC would necessarily be prevented from discharging its statutory duty under sections 1 and 2(a) [47 U.S.C. § 151 and § 152] to regulate interstate communication."

552 F. 2d at 1045.

23. Commenting that there "can be no doubt that, when the Communications Act was passed, Congress envisioned circumstances in which the same equipment would be employed for both interstate and local communication" (at 1046), the Fourth Circuit disposed of the argument that FCC jurisdiction is limited to equipment used predominantly for interstate purposes:

"The question is whether jointly used facilities are to be classified for jurisdictional purposes as the 'interstate facilities of sections 1, 2(a) and 3(a), or as the 'intrastate' facilities of section 2(b) (1). Sections 1, 2(a) and 3(a) [47 U.S.C. §§ 151, 152(a) and 153(a)] commit jurisdiction over facilities utilized in interstate communication to the FCC. Section 2(b) (1) [47 U.S.C. § 152 (b) (1)] does not deny the FCC jurisdiction with respect to *interstate* facilities: it excludes only *intrastate* facilities from FCC jurisdiction. The terminal equipment dealt with in the order appealed from is

used for *both* interstate and intrastate communication. *The withdrawal of jurisdiction over one cannot be read to mean the withdrawal as to the other.*" 522 F. 2d at 1046, emphasis added.

24. In summary, the *North Carolina I* and the *North Carolina II* decisions, which involved fundamental changes in the practice and even in the structure of the telecommunications industry, are the clearest enunciation of the *governing principle* that FCC jurisdiction under the Communications Act extends to all equipment employed for the provision of telephone service, since all such equipment is used, at least in part, for interstate or foreign communications. *Accord, Puerto Rico Telephone Company v. FCC*, 553 F. 2d 694 (1st Cir. 1977); *People of the State of California v. FCC*, 567 F. 2d 84 (D. C. Cir. 1977), cert. denied 434 U.S. 1010 (1978); *Southern Pac. Communications v. Corp. Com'n.*, 586 P. 2d 327 (Okla., 1978); *Clifton v. Cox*, 549 F. 2d 722, 730 (9th Cir. 1977); *New York Tel. Co. v. FCC*, 631 F. 2d 1059 (2d Cir. 1980); *GTE Service Corp. v. FCC*, 474 F. 2d 724 (2d Cir. 1973); *General Telephone Company of California v. FCC*, 413 F. 2d 390 (D.C. Cir. 1969).

25. In the cases discussed above, decided in the First, Second, Fourth, and D. C. Circuits, board statutory authority of the FCC was found to support the preemptive action taken. The FCC's authority and indeed, mandatory duty, under Section 220(b) of the Act, to prescribe depreciation rates is considerably more specific than the statutory basis for the FCC actions held to preempt the states in the foregoing cases. All of these recent cases make absolutely clear the jurisdictional base for FCC authority to carry out its duty under Section 220(b).

26. The unambiguous language of Section 220(b) of the Act demonstrates that Congress has in fact empowered and directed the FCC to set depreciation rates for all equipment and plant. General is fully subject to FCC jurisdiction, including the provisions of Section 220 which are concerned with the setting of depreciation rates for all of the company's plant and equipment:

"Sec. 220(b) The Commission *shall*, as soon as practicable, *prescribe* for such carriers the classes of property for which

depreciation charges may be properly included under operating expenses, and *the percentages of depreciation* which *shall* be charged *with respect to each of such classes of property*, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. Such carriers *shall* not, after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property *other than those* prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation *other than* that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses." (Emphasis added)

27. Section 220(b) explicitly spells out the FCC's *responsibility* to prescribe both the classes of property for depreciation purposes, and the percentages of depreciation for each class, which was recognized by the Commission in Docket No. 20188. See 83 FCC 2d at 272, 273. Futhermore, in addition to assigning these responsibilities to the FCC, Congress explicitly (and with redundant emphasis) prohibited carriers from departing from any FCC prescriptions in various paragraphs of Section 220. See Subsections (b) and (g):

> "... *it shall be unlawful for such person to keep any other accounts, records, or memoranda than those so prescribed or such as may be approved by the Commission or to keep the accounts in any other manner than that prescribed or approved by the Commission....*" 47 U.S.C. Section 220(g), (emphasis added.)

Sections 220(d) and (e) contain provisions for the assessment of civil or criminal penalties upon persons failing or refusing to abide by the Commission-prescribed standards.

28. Congress could not have expressed its intent in more lucid and unambiguous language. The FCC has the power, in its discretion under Section 220(a), to prescribe accounting requirements for carriers, and it has the duty and responsibility under Section 220(b) to prescribe depreciation methodology and accrual rates. Once the FCC prescribes "the classes of property for which depreciation may be properly included under operating expenses, and the percentages of depreciation," the carriers are required to comply, and are subject to forfeitures and/or prosecution for failure to comply.

29. Congress recognized the importance of the FCC's obtaining the views of state commissions in the course of prescribing accounts, records, and memoranda. In Subsection (i) of Section 220 of the Act, it was provided that:

> "(i) The Commission before prescribing any requirements as to accounts, records, or memoranda, shall notify each State Commission having jurisdiction with respect to any carrier involved, and shall give reasonable opportunity to each such commission to represent its views, and shall receive and consider such views and recommendations."

30. Finally, the concluding subsection to Section 220 reinforces the clear intent of Congress that the FCC alone would act, but would seek the advice and counsel of state commissions:

> "(j) The Commission shall investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the Commission and of State Commissions with respect to matters to which this section relates."

31. In view of the unambiguous language of Subsections (i) and (j) of Section 220 of the Act, one must ask why Congress would direct the FCC to seek out state commission opinions and views if: (a) the states were to have the final authority on "intrastate" depreciation rates; or, alternatively, (b) if Section 220 was to be applied solely to "interstate" equipment and plant (assuming *arguendo* that there is such a segregable body of equipment and plant) which would clearly be solely under FCC cognizance. The answer to both of these questions is that Con-

gress intended that the FCC should be the final arbiter of depreciation rates for *all classes of property*.

32. In contrast to the Communications Act, provisions of two other Acts enacted close in time to the Communications Act, the Natural Gas Act and the Federal Power Act, provide explicitly that depreciation rates prescribed by the relevant federal commission are not to be binding upon State Commissions in intrastate ratemaking.[4] Thus, Congress was quite capable of reserving State Commission authority to determine depreciation rates for intrastate ratemaking when it wished to do so. However, with the Communications Act, Congress withheld such authority from the states.

VI. FAILURE TO PREEMPT INCONSISTENT STATE DEPRECIATION RATES WILL RESULT IN WIDESPREAD DISREGARD BY THE STATES OF FCC DEPRECIATION ORDERS

33. The PUCO's April 26, 1982 Order (Exhibit A) is one of a growing number of instances where the states have refused to accept the depreciation orders of this Commission. In Ohio, it appears that at least two other telephone companies will be similarly affected. The PUCO refused to accept FCC prescribed

[4] Section 9(a) of the Natural Gas Act, 15 U.S.C. § 717h(a) (June 21, 1938) provides:

> "Nothing in this section shall limit the power of a State Commission to determine in the exercise of its jurisdiction, with respect to any natural-gas company, the percentage rates of depreciation or amortization to be allowed, as to any class of property of such natural-gas company, or the composite depreciation or amortization rate, for the purpose of determining rates or charges."

Section 302(a) of the Federal Power Act, 16 U.S.C. § 825a(a) (August 26, 1935) provides:

> "Nothing in this section shall limit the power of a State Commission to determine in the exercise of its jurisdiction, with respect to any public utility, the percentage rate of depreciation to be allowed, as to any class of property of such public utility, or the composite depreciation rate, for the purpose of determining rates or charges."

depreciation rates for terminal equipment accounts for the Ohio Bell Telephone Company in Case Nos. 81-436-TP-AIR and 80-1010-TP-AAM, Opinion and Order of April 21, 1982. Further, General is informed that in a recent three-way meeting between the staffs of this Commission, the Ohio and Kentucky Commissions, and Cincinnati Bell, Inc., the Ohio Staff again refused to accept the use of equal life group and remaining life depreciation methodology, although agreeing to the underlying average service lives and average net salvage values.

34. As noted by this Commission in its Memorandum Opinion and Order in CC Docket 79-105, FCC 82-155 released April 27, 1982, the California Commission, with the approval of the California Supreme Court, has refused to accept depreciation methods prescribed by this Commission. *Pacific Tel. & Tel. Co. v. California*, 401 P. 2d 353, 372-73 (1965). This Commission further noted that the Florida Public Service Commission has concluded that it is not required to use depreciation methods prescribed by this Commission. *Southern Bell Telephone & Telegraph Co.*, 66 PUR 3d 1, 57-58 (1966).

35. The Alabama Public Service Commission has served notice that it will not follow depreciation prescriptions of this Commission. Re *Telephone Terminal Equipment & Accounting Practices*, General Order, July 17, 1981, 43 PUR 4th 645, 648. The Nebraska Public Service Commission has issued a similar order. See Opinion and Findings dated September 1, 1981, regarding proposed Rule & Regulation 54. So has the Louisiana Public Service Commission. See General Order dated June 30, 1981. While the primary focus of these decisions is the FCC's Second Computer Inquiry, they also challenge FCC authority to act preemptively under Section 220 of the Communications Act in matters of accounting practices and depreciation. The Staff of the Michigan Public Service Commission has taken the position of refusing to accept depreciation accrual rates prescribed by this Commission in *In the Matter of the Application of General Telephone Company of Michigan for Approval of Depreciation*

Practices, Case No. U-6587, presently pending before the Michigan Public Service Commission.[5]

36. Public Service Commissions in thirteen states filed initial comments in Docket No. 20188, seven of which (California, Colorado, Florida, Kentucky, Maryland, New York, and Wisconsin) were discussed in the Commission's Report and Order. As stated by the Commission, "The principal reason given by the State Commissions for opposing ELG was that its adoption would result in an increase in revenue requirements. . . ." (Paragraph 41) Following the release of the Commission's Report and Order in Docket 20188, the National Association of Regulatory Utility Commissioners (NARUC) filed a Petition for Reconsideration, arguing that the adoption of ELG and the use of remaining life "will substantially increase revenue requirements and thereby subscriber rates." The Commission rejected NARUC's concern for increased revenue requirements as not inconsistent with the Commission's mandate under Section 1 of the Act, and further rejected alternatives suggested by NARUC as not dealing "with the need to improve capital recovery promptly in light of competitive and technological conditions in the marketplace." *Reconsideration*, paragraphs 5, 6.

37. The foregoing discussion provides some indication of the turmoil existing and in prospect at the state level following from months of delay by the Commission in issuing its reconsideration decision in CC Docket 79-105. The action of the PUCO in ordering depreciation rates in conflict with FCC-prescribed rates presents this Commission with a specific case of actual federal/state conflict involving over $7 million in depreciation charges. The Commission should resolve this matter by prompt, decisive action affirming the FCC's jurisdictional power and

[5] Although it has not had the opportunity to review commission decisions in the following states, General is informed that in addition to those states mentioned above, jurisdictions recently denying proposed remaining life and/or ELG depreciation rates include the following: District of Columbia, Georgia, Idaho, Kansas, Maryland, Massachusetts, Pennsylvania, South Carolina, South Dakota, Washington, and West Virginia.

making unmistakable the Commission's intention to see actual recovery of capital under its Docket 20188 policies.

SUMMARY

In summary, General submits that the PUCO's Order of April 26, 1982 is inconsistent with the Orders of this Commission released January 28, 1982 (FCC 82-40) and February 3, 1982 (FCC 82-53), and that the PUCO's Order frustrates policies which this Commission has adopted to carry out its statutory objectives. The PUCO's Order rejects equal life group and remaining life depreciation methodologies, methodologies which this Commission has specifically prescribed for General and has determined are appropriate and necessary in order for carriers to realize full capital recovery, and to take advantage of new technology which is necessary to improve telecommunications service.

RELIEF REQUESTED

WHEREFORE, General asks that the Commission issue its Order preempting the use by the PUCO, for General, of any depreciation accural rates and methods other than those prescribed by this Commission.

Respectfully submitted,

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EXHIBIT "A"

Opinion and Order, May 19, 1981, at p. 13 and *Ohio Bell Telephone Company*, Case No. 79-1184-TP-AIR, Entry on Rehearing, January 29, 1981, at p. 1.

Postage Expense Increase

The applicant objected to the Staff's failure to adjust operating expenses to reflect the annualization of the postage expense increase which became effective on November 1, 1981. Staff witness Montgomery agreed with this objection and revised his total jurisdictional postage expense adjustment from $50,354 in the Staff Report (Staff Ex. 1, Schedule 3.10) to $189,869 (Staff Ex. 13A, Schedule RGM-3). The Commission will adopt the Staff's revision.

Rate Case Expense

Consumers' Counsel raised its traditional objection to the inclusion of rate case expense. OCC witness Miller stated that if the Commission were to include rate case expense as an allowable operating expense, he would support the Staff's recommended two year amortization period (OCC Ex. 1, p. 21). As we have stated in numerous cases, the preparation, filing and prosecution of rate cases constitute a normal and necessary part of a utility's operations, and must therefore be reflected in the cost of service. *See, e.g., Cleveland Electric Illuminating Co.*, Case No. 78-677-EL-Air, Opinion and Order, May 2, 1979, at p. 26. The Commission will overrule this objection and permit an allowance of the estimated rate case expense of $75,961 amortized over two years or a test year allowance of $37,980.

Trustee Expense

The Staff did not include as an allowable expense the applicant's proposed trustee expense adjustment of $12,000 on a total company basis. Company witness King testified that General retains the services of the National City Bank of Cleveland and the Chemical Bank New York Trust Company to serve as trustees for first mortgage bond, debenture and supplemental indentures. The duties of these trustees include registering bonds,

authenticating bonds, cancelling and destroying bonds and coupons, keeping lists of bond holders, mailing reports to bond holders, holding undelivered bonds, maintaining ledger accounts for the bonds, and reporting on the issuance and transfer of bonds. In summary, the trustee expense is for the ongoing administration of bonds (Tr. XV, 20). These trustee expenses are charged to Account 323 and are not accounted for as legal expenses nor are they duplicated on Schedule D-3 of the Standard Filing Requirements. The Commission finds these expenses are ordinary and necessary utility business expenses and has included a jurisdictional allowance of $9,000 for trustee expense.

Depreciation Expense (Case Nos. 80-1124-TP-AAM and 81-354-TP-AAM)

A brief summary of the history of the proceedings in the above cases was set forth at the outset of this Opinion and Order and need not be repeated. The question of the appropriate depreciation accrual rates to be authorized and utilized for purposes of setting rates has been consolidated into these cases. Annual depreciation accrual rates are prescribed every three years for General by both the FCC and this Commission. Since the items in each plant account are used for both interstate and intrastate service, the appropriate accrual rates are generally agreed upon by both Commissions as a result of a three way meeting between representatives of the applicant and the staff of the FCC and of this Commission. However, at the three way meeting held on June 11 and 12, 1981, the three parties agreed only on the average service lives and average net salvages. The applicant and the staff of the FCC advocated use of "remaining life" rates and the use of the equal life group (ELG) procedure of grouping property units. The staff of this Commission recommends the use of "whole life" rates as proper and adequate as well as the vintage group procedure. The company objected to the Staff's recommendations.

By its Report and Order in Docket No. 20188 released December 5, 1980, the FCC indicated that it would amend its rules to permit the use of remaining life depreciation rate calculations. In its Order in FCC 82-40 30744 released January 28, 1982, the

FCC authorized the use of remaining life rates for GTO. On February 3, 1982, the FCC released its Order prescribing ELG rates for General's outside plant accounts, effective January 1, 1982.

In the context of this rate case, the issue, of course is whether remaining life and/or ELG rates on the one hand, or the use of whole life and vintage group rates on the other hand, should be used for purposes of determining the proper allowance for depreciation expense. This question is of more than academic interest, for the difference in expense dollars between the two sets of rates is approximately $7 million (Co. Ex. 52, King Ex. 15; Tr. XIV, 67). The Commission perceives this issue as involving a legal question as well as a policy question. For purposes of discussion, we will discuss the legal question first, followed by the remaining life rates versus whole life rates issue, and finally, an examination of equal life group procedures and vintage group procedures.

The threshold question which must be addressed, if not decided, is whether the Commission has any discretion at all in the matter. Applicant argues federal preemption, contending that the FCC's prescription of remaining life depreciation rates forecloses this state commission from reaching a contrary result. This places the Commission in a somewhat awkward position for, on the one hand, it is not our province to decide constitutional questions, while, on the other, we must make some determination as to our authority to proceed. On brief, Staff counsel points out that the Commission has a duty under Section 4905.18 Revised Code to "ascertain, determine, and prescribe what are proper and adequate charges for depreciation . . . " and that the Commission "may prescribe such changes in such charges for depreciation as it finds necessary" (Staff Initial Brief, p. 24). Moreover, in establishing rates for utility service, the Commission must give due regard to the "necessity of making reservation out of the income for . . . depreciation . . . " Section 4909.15(D)(1) Revised Code. (*See also* Section 4909.05(H) Revised Code). Pursuant to this obligation and authority we will take up the merits of the depreciation controversy, leaving the constitutional question to other forums. To decide the preemption issue would require us to rule on the constitutionality of the cited statutes or to simply

disregard the duties they impose. Neither alternative is acceptable. We would note in passing, however, that none of the arguments advanced by applicant would appear to us to compel the conclusion that the federal government, through the FCC, has occupied the field; for the "field" is the setting of fair and reasonable rates for intrastate telephone service, an activity over which the FCC has no authority. Indeed, in the only judicial decision cited to our attention which involves this precise question, the preemption argument was rejected. *Pacific Telephone and Telegraph Co. v. Public Utilities Commission*, 401 P.2d 353, 372-373, 58 PUR 3d 229, 253-254 (1965). Further, requiring the applicant to maintain different accrual rates with respect to its interstate and intrastate property creates no conflict and places no undue burden on the company as it has been ordered by the FCC to maintain both whole life and remaining life depreciation studies during the next represcription period in any event.

Staff witness Fox testified in support of depreciation accrual rates derived from the whole life methodology (Staff Ex. 11, pp. 6-27; generally Tr. XIV). Company witnesses Dennis and White testified in support of the use of remaining life rates (Co. Ex. 24, p. 15; Tr. V, 154-162; VI, 63-120; VII, 63, 75, 99; Co. Ex. 59; Tr. XXII, 7-58). We will review briefly the mechanics of the two techniques.

Under the whole life method, the depreciation accural rate is determined by dividing the original cost of an asset or vintage group of assets, less average net salvage, by the estimated average service life. If the estimate of average service life changes for any reason, a new depreciation rate is determined based on the new estimate. The rate so determined is the same as the rate which would have been in effect had the initial service life estimate been correct. Under the remaining life approach, the process is the same up to the point where the average service life estimate changes. The new accrual rate is then determined by dividing the undepreciated portion of the original cost of the asset or vintage group, less net salvage, by the average remaining life. Thus, the remaining life accrual rate is, essentially, whatever rate is necessary to produce a total return of the initial capital.

The principal evil of the whole life methodology in applicant's view is that it does not provide for complete capital recovery under conditions of rapidly changing technologies where service lives, particularly in the terminal equipment area, are heavily influenced by competitive forces (Co. Initial Brief, pp. 53-55). As applicant maintains, under whole life, the depreciation reserve will, as a mathematical certainty, eventually end up over- or underaccrued whenever there has been change in the estimated average service life. In earlier years, where these competitive forces were not as pervasive, this was of no great moment, for over- and underaccruals were presumed to generally cancel one another out. However, with the onset of competition, the environment is no longer unbiased, and changes in service life estimates are no longer basically related to new perceptions of an item's physical properties, but rather to technological obsolescence. Thus, the company argues, the remaining life procedure must be used in order to allow full capital recovery.

The whole life proponents, although conceding that the remaining life method is designed to permit a full return of capital, contend that the technique is inconsistent with proper regulatory theory, is not permissible under Ohio law, and, as a practical matter, is no more likely to produce an accurate result than the whole life method, We find something of merit in each of these arguments. We turn first to the theoretical questions.

Depreciation is nothing more than a procedure by which to allocate the cost of an asset over its life (Staff Ex. 11, p. 7; Co. Ex. 59, p. 6; Tr. XXII, 9-11). Under the straight line methods used for book accounting and regulatory purposes, the assumption is that the cost should be distributed equally over the asset's life, or in the case of a vintage group, over the average life of the assets comprising the group. Thus, when evidence indicates that the original life estimate was incorrect, even though it represented the best judgment possible at the time, it is clear that there has been a misallocation of cost. The whole life method does not attempt to correct for this past misallocation. Whole life depreciation accrual rates merely generate the annual expense which would have been incurred had the original service life estimate been correct. In the context of the ratemaking process, this means that the current

ratepayer is asked to pay only what he would have been charged for depreciation expense if the proper accrual rates had been in place, from the time the asset or vintage group of assets was placed in service. Given the nature of the ratemaking process, this can certainly be viewed as an appropriate standard by which to determine a reasonable allowance for depreciation expense. The remaining life method, on the other hand, attempts to remedy this past misallocation by charging current ratepayers for the past underrecovery of depreciation expense (Tr. VII, 99). As discussed below, there may be legal constraints which preclude this result, but some comment is in order relative to the conceptual problems posed by this aspect of the remaining life technique. This attempt to correct for past misallocations shifts certain risks properly borne by the company's investors to its ratepayers. The most obvious of these is what might be loosely referred to as regulatory risk, that is, the risk which flows both from the fact of regulation and from individual regulatory decisions. The more significant risks for purposes at hand, however, are the business risks associated with applicant's competitive endeavors, here, specifically, the risk of technological obsolescence. The remaining life method tends to insulate the investor from all this.

From a legal standpoint, remaining life is on something less than solid ground. This Commission has previously been presented with proposed depreciation accrual rates utilizing remaining life rates and has rejected such rates primarily because we found it would be unfair to make present and future ratepayers "pay for the past inadequacy" of past depreciation rates. *See, e.g. Dayton Power and Light Co.,* Case No. 79-372-GA-AIR, Opinion and Order, May 7, 1980, at p. 14. We also believe that the implications of *C&SOE v. Pub. Util. Comm.* (1980), 64 Ohio St.2d 175 and *Consumers' Counsel v. Pub. Util. Comm.* (1981), 67 Ohio St.2d 153 address this issue. Although these decisions are not on all fours factually with the instant case, the Ohio Supreme Court's pronouncements with respect to the impropriety of recovering past losses through present and future rates can certainly not be ignored. Of particular interest is the fact that the Court did not view the reasonableness or prudence of the initial decisions, be it the Commission's, as in *Columbus and Southern, supra,* or management's, as in *Consumers' Counsel, supra,* to be material to

the question of whether the loss occasioned thereby could be recognized through future rates. Here, the present accrual rates were fixed by the Commission based on the best evidence available at the time. The fact that the estimate of service lives has not changed does not justify charging the present ratepayers for this past misallocation.

Although there is something attractive about the symmetry of the remaining life method with its nominal full return of capital, the realities of the situation are such that there is no real assurance that remaining life, particularly as it has been calculated in this case, will yield a more reasonable result than the whole life method. The first point to be made in this connection is that if an asset has not been fully depreciated at the end of its actual useful life, the dollars associated with the undepreciated portion remain in the account in question. This is not to suggest that it is desirable to create this increment of permanent rate base, but merely to point out that the company does continue to realize a return on that portion of the asset that is not refunded through depreciation accruals (Tr. VI, 73). If we were dealing with a single item of property, this permanent rate base phenomenon would be a matter of some concern, but the fact is that we are dealing here with mass accounts subject to a continual stream of additions and retirements. Individual items within the accounts will be overaccrued or underaccrued at any point in time regardless of the depreciation method adopted. Moreover, under remaining life, all additions after the represcription will necessarily be overaccrued.

The results under remaining life might be slightly more tolerable if one could be absolutely assured that the additional costs associated with the use of the method would be charged specifically to the items of equipment with which the increased expense is associated. However, as General's service offerings are not tariffed pursuant to a comprehensive, fully allocated cost study, there is no such guarantee. Thus, under remaining life, not only are customers required to bear the risk of technological obsolescence; some are asked to bear this risk in connection with services that, in most instances, they cannot even use.

With due regard for these considerations, the Commission is of the opinion that the whole life depreciation rates recommended by the Staff produce a reasonable allowance for depreciation expense. We will utilize the whole life method here.

General also proposed using the equal life group method in determining depreciation expense for outside plant accounts. This method was authorized by the FCC effective January 1, 1982. The equal life group method is a refinement of the vintage life group procedure. Whereas the vintage life group attempts to group property units which were placed into service at about the same year, the equal life group method goes one step further and attempts to group "property units within a vintage that are expected to have the same service life" (Co. Ex. 59, p. 8). Mr. Dennis testified that the equal life group (ELG) or unit summation approach is more precise because it recognizes that some assets in a functional group are retired before the average for the group, and other assets remain in service longer than the average (Tr. VII, 55-56).

The Staff generally supported the concept of the ELG method but recommended disapproval in this case. We agree with the Staff that the effect of the ELG method has not been isolated from the proposed remaining life rates. The commission will adopt the whole life-vintage group rates recommended by the Staff. The applicant's objection will be overruled.

(6) The company should be authorized to cancel and withdraw its current tariffs on file with this Commission and to file revised proposed tariffs consistent in all respects with the discussion and findings set forth above.

(7) General's existing rate structure for competitive communications systems and equipment is unjust, unreasonable and unjustly discriminatory in that it prevents the company from responding promptly to changes in competitive market conditions and effectively, from optimizing the contribution from such systems and equipment.

(8) The flexible rate structure for competitive communications systems and equipment providing for minimum and maximum rate levels, as set forth in the proposed tariff

regulation in this case, will reduce the unjust discrimination inherent in competition between regulated and unregulated suppliers.

ORDER:

It is, therefore,

ORDERED, That the application of General Telephone Company of Ohio for authority to increase its rates and charges for telephone service be granted to the extent provided in this Opinion and Order. It is, further,

ORDERED, That the company is authorized to normalize the tax benefits from the accelerated cost recovery system of depreciation and the investment tax credit on its recovery property placed in service after December 31, 1980. It is, further,

ORDERED, That the company is authorized to cancel and withdraw its present tariffs and to file revised proposed tariffs consistent with the discussion and findings set forth above. Upon receipt of three (3) copies of revised proposed tariffs conforming to this Opinion and Order, the Commission will review and if appropriate, approve the tariffs by Entry. It is, further,

ORDERED, That the effective date of the new tariffs shall be the date said tariffs are accepted for filing by Commission Entry. The new rates included therein shall be applicable to all service rendered on and after the effective date. It is, further,

ORDERED, That the company submit a proposed notice of the increase in rates and charges authorized in this Opinion and Order when it files its tariffs for approval. The Commission will review the proposed notice and, if proper, approve it by Entry. Upon approval of the notice, the company shall immediately begin to notify its customers by insert or attachment to its billings, by special mailing, or by a combination of the above. Notice to customers should be completed within thirty (30) days of the approval of the tariffs and the notice. It is, further,

ORDERED, That the new depreciation accrual rates prescribed in this Opinion and Order be applied to its intrastate plant commencing May 1, 1982, and shall continue to be applied until the Commission orders otherwise. It is, further,

EXHIBIT "B"

FEDERAL COMMUNICATIONS COMMISSION
Schedule of Annual Percentages of Depreciation for
GENERAL TELEPHONE COMPANY OF OHIO

Acct. No.	Class or Subclass of Plant	Avg. Serv. Life (Yrs.)	Avg. Net Salv. (%)	Whole Life Rate (%)	Avg. Rem. Life (Yrs.)	Fut. Net Salv. (%)	Rem. Life Rate (%)
212	Buildings	30	8	3.1*			
221	Central Office Equipment						
	Manual Switching				5.8	−4	13.3
	Automatic Sw (Electro-Mech)				6.7	1	9.3
	Automatic Sw (Analog)				18.1	1	4.9
	Automatic Sw (Digital)				25	1	4.0
	Automatic Message Recording				6.1	1	11.4
	Circuit				12	11	5.6
	Radio				8.2	2	6.5
231	Station Apparatus						
	Telephone				7.1	1	11.3
	Small PBX				2.7	1	36.2
	Telephone Booths				7.8	0	13.9
	Teletypewriter				6.3	1	10.2
	Radiotelephone				6.9	0	8.7
232	Station Connections—Other				—	—	5.0#
234	Large Private Branch Exchanges				5.1	3.5	13.0
241	Pole Lines				11.9	−36	9.3
242.1	Aerial Cable				22	−18	3.9
242.2	Underground Cable				24	22	4.0
242.3	Buried Cable				26	−5	3.4
242.4	Submarine Cable				12.8	0	4.9
243	Aerial Wire				5.3	−67	57.8
244	Undergound Conduit				48	−12	1.8
261	Furniture & Office Equipment				15.7	12	3.0
264	Vehicles & Other Work Equipment						
	Motor Vehicles				4.5	13	9.3
	Shop Equipment				7.8	5	9.3
	Tools & Other Work Equipment				13.5	11	4.1

*Depreciation rate prescribed previously

#This rate is not based upon life and salvage factors

All rates are effective December 1, 1981 except Account No. 232 which is effective October 1, 1981

EXHIBIT "C"

FEDERAL COMMUNICATIONS COMMISSION
Schedule of Annual Percentages of Depreciation
Calculated under the Equal Life Group Methodology for
GENERAL TELEPHONE COMPANY OF OHIO
Effective January 1, 1982

Acct. No.	Class or Subclass of Plant	Serv. Life (a) (Yrs.)	Net Salv. (b) (%)	Curve Shape (c)	ELG Rates for 1982 and Later Vintages — Age at Beginning of Year 0.0 (d) (%)	0.5 (e) (%)	1.5 (f) (%)	Net Salv. Rate (g-b/a) (%)
241	Pole Lines	20	−36	*	12.3	8.9	7.3	1.8
242.1	Aerial Cable	30	−18	*	5.6	4.7	4.3	0.6
242.2	Underground Cable	32	−22	*	5.3	4.4	4.0	0.7
242.3	Buried Cable	32	− 5	*	4.1	3.9	3.8	0.2
242.4	Submarine Cable	23	0	R2	6.5	5.8	5.5	0
244	Underground Conduit	60	−12	R2	2.6	2.4	2.3	0.2

* A Gompertz-Makeham Curve using the c, G & S values provided in the carrier's studies.

EXHIBIT "D"
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GENERAL TELEPHONE COMPANY OF OHIO
Case No. 81-383-TP-AIR
Jurisdictional Depreciation Expense
($000's Omitted)

Acct. No.	Account Description	Jurisdictional Plant in Service (a)	Accrual Rate % (b)	Jurisdictional Depreciation Expense (c)
201	Organization	$ 22	0.0	$
202	Franchise		0.0	
203	Patent Rights		0.0	
211	Land	2,885	0.0	
212	Buildings	46,315	3.1	1,436
221	*Central Office Equipment*			
	Manual Switching	6,152	8.1	498
	Automatic Switching	144,859	6.8	9,850
	Automatic Message Recording	17,132	8.1	1,388
	Circuit	57,163	5.4	3,087
	Radio	858	6.3	54
231	*Station Apparatus*			
	Telephone Station	50,712	9.3	4,716
	Small PBX	2,045	13.9	284
	Booths	753	8.9	67
	Teletypewriter Equipment	2,228	10.5	234
	Radiotelephone Equipment	274	10.0	27
232	*Station Connections*			
	Telephone	53,249	13.1	6,976
	Teletypewriter	174	13.1	23
	Radiotelephone	53	13.1	7
234	Large PBX	12,456	11.2	1,395
241	Pole Lines	19,104	6.4	1,223
242.1	Aerial Cable	88,911	4.0	3,556
242.2	Underground Cable	15,819	3.8	601
242.3	Buried Cable	77,125	3.5	2,699
242.4	Submarine Cable	98	4.0	4
243	Aerial Wire	3,705	15.5	574
244	Underground Conduit	7,054	1.9	134

(a) Staff's Schedule 8
(b) Refer to Text
(c) = (a) x (b)

EXHIBIT "D"
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GENERAL TELEPHONE COMPANY OF OHIO
Case No. 81-383-TP-AIR
Jurisdictional Depreciation Expense
($000's Omitted)

Acct. No.	Account Description	Jurisdictional Plant in Service (a)	Accrual Rate % (b)	Jurisdictional Depreciation Expense (c)
261	Furniture & Office Equipment	$ 5,039	4.0	$ 202
264	*Veh. & Other Work Equipment*			
	Motor Veh.	11,108	12.4	(d)
	Motor Veh. Shop Equipment	139	9.2	(d)
	Tools & Other Work Equipment	6,996	5.0	(d)
276	Telephone Plant Acquired		0.0	
277	Telephone Plant Sold	(1)	0.0	
	Subtotal	632,427	6.17(e)	39,035
	Station Connection-Inside Wiring Adjustment(f)	(405)	—	(2,623)
	Total Depreciation & Amortization Expense	$632,022	5.76(e)	$36,412

(a) Staff's Schedule 8
(b) Refer to Text
(c) = (a) x (b)
(d) Charged to Clearing Account
(e) Composite—Shown for Illustration Only
(f) Drop at 5% = 964,478 plus Amortization of 4,795,010 = 5,759,488 Less Current Total 232 Expense of 9,201,815 = $3,442,327 decrease in Total Company Expense x .761909 = $2,622,740

EXHIBIT "E"
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THE EFFECT OF DIFFERENT JURISDICTIONAL DEPRECIATION RATES IN THE PRESENCE OF CHANGING JURISDICTIONAL ALLOCATION FACTORS IS TO PREVENT 100% CAPITAL RECOVERY

The attached examples show that the use of different depreciation methodologies for the interstate and intrastate portions of General's plant accounts will not achieve the objective of one hundred percent capital recovery—no more and no less—except by sheer and remote chance. This is because jurisdictional allocation factors are based on changing usage studies (of both holding times and message volumes) and are revised monthly. Investment and expenses, including depreciation, allocated to interstate and intrastate services, change monthly for purposes of jurisdictional separations and settlements as a result of usage changes. The use of different depreciation rates for interstate and intrastate purposes will mean either (i) that General will *never realize* full capital recovery, or (ii) General will realize an *over-recovery*. In either case, the ratepayer will be disserved.

To illustrate the effect of changing jurisdictional allocation factors, Schedule E-1 and Schedule E-2 set forth a Single Asset Example with two variations in the separations factors over four years.

As shown in Schedule E-1, on an original investment of $100, General would recover only $98.75, resulting in failure *ever* to recover $1.25, constituting 1.25%, of the original investment—even though both the interstate and intrastate "books" would indicate full capital recovery.

Conversely, as shown in Schedule E-2, on an original investment of $100, General would recover $101, for a $1 over-recovery, even though both sets of "books" would indicate nothing more than full capital recovery.

These illustrations are intended to frame the problem in simplified, understandable terms. The conflict between FCC prescriptions of depreciation methodologies and rates and state determinations must necessarily result in destroying any assurance that the depreciation process will be allowed to work as intended, providing recovery of just the amount invested, not more, not less.

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SCHEDULE E-1

SINGLE ASSET EXAMPLE

Given:
- $100 Single Asset
- $ 0 Net Salvage
- 4 Year Physical Life
- 4 Year Depreciation Life—State—Whole Life
- Initial 3 Year Depreciation Life—Interstate—Remaining Life Revised at End of Year 2 to 2 Years Remaining
- Separation Changes as Shown Below:

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	Total of Years 1-4
1. Separation Factor State	.80	.75	.70	.70	N/A
2. Separation Factor Interstate	.20	.25	.30	.30	N/A
STATE BOOKS					
3. Total Recorded Depreciation	$25.00	$25.00	$25.00	$25.00	$100.00
4. State Rev. Rqmt. Dept. (line 1 × line 3)	20.00	18.75	17.50	17.50	73.75
INTERSTATE BOOKS					
5. Total Recorded Depreciation	33.33	33.33	16.67	16.67	100.00
6. Interstate Rev. Rqmt. Dept. (line 2 × line 5)	6.67	8.33	5.00	5.00	25.00
COMPOSITE					
7. Total Capital Recovered (line 4 + line 6)	$26.67	$27.08	$22.50	$22.50	$ 98.75

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Page 3 of 3

SCHEDULE E-2

SINGLE ASSET EXAMPLE

Given:
- $100 Single Asset
- $ 0 Net Salvage
- 4 Year Physical Life
- 4 Year Depreciation Life—State—Whole Life
- Initial 3 Year Depreciation Life—Interstate—Remaining Life Revised at End of Year 2 to 2 Years Remaining
- Separation Changes as Shown Below:

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	Total of Years 1-4
1. Separation Factor State	.70	.75	.80	.80	N/A
2. Separation Factor Interstate	.30	.25	.20	.20	N/A
STATE BOOKS					
3. Total Recorded Depreciation	$25.00	$25.00	$25.00	$25.00	$100.00
4. State Rev. Rqmt. Dept. (line 1 × line 3)	17.50	18.75	20.00	20.00	76.25
INTERSTATE BOOKS					
5. Total Recorded Depreciation	33.33	33.33	16.67	16.67	100.00
6. Interstate Rev. Rqmt. Dept. (line 2 × line 5)	10.00	8.33	3.33	3.33	24.99
COMPOSITE					
7. Total Capital Recovered (line 4 + line 6)	$27.50	$27.08	$23.33	$23.33	$101.24

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

CC Docket 79-105

In the Matter of
Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies, of the Commission's Rules and Regulations with respect to accounting for station connections, optional payment plan revenues and related capital costs; customer provided equipment and sale of terminal equipment.

JOINT PETITION FOR CLARIFICATION

[Filed June 8, 1982]

GTE Service Corporation and its affiliated domestic telephone companies; United Telephone System, Inc., on behalf of the companies comprising the United Telephone System; and Continental Telecom Inc., on behalf of its telephone operating companies; ("the Joint Petitioners"), pursuant to Section 1.429 of the Commission's Rules, ask the Commission to clarify the Memorandum Opinion and Order (the order) released April 27, 1982, FCC 82-155, as follows:[1]

OVERVIEW

As it relates to depreciation, the Order does not reflect the Commission's intent.

Without clarification, the Order will have very serious effects, not intended by the Commission, imperiling established Commission policies and statutory objectives—including full and timely

[1] 47 Fed.Reg. 19361, May 5, 1982. The Petition meets the test of Section 1.429(b) in that its facts relate to change in scope of the original Order, upon which there has been no opportunity to comment. Moreover, the public interest requires the further reconsideration asked here.

recovery of invested capital under Docket 20188[2] and implementation of the Commision's CPE deregulation program under Docket 20828[3] and CC Docket 81-893.[4]

The Order (¶ 8) announces that "Section 220 [of the Communications Act] does not preclude state commissions from departing from accounting *or depreciation* rules prescribed by this Commission for purposes of regulating intrastate telecommunication service rates" (emphasis added). This conclusion sweeps well beyond station connection accounting. It embraces depreciation as well as accounting requirements; it embraces matters covered by § 220(a) as well as § 220(b) of the Act.[5] And yet the discussion in Part II[6] of the Order, cited to support this conclusion, is exclusively concerned with § 220(a) matters (accounting requirements) and provisions related thereto, particularly § 220(g).

No support for any conclusion whatever regarding § 220(b) matters (prescription of depreciation methodologies and rates) is found anywhere in Part II of the Order. Furthermore, the quoted conclusion would appear to permit *any* form of state departure from depreciation, as well as accounting, rules prescribed by the FCC. But the Part II discussion merely leads to the determination that "in this instance . . . federal regulation will not be frustrated if carriers maintain additional records for intrastate ratemaking purposes" (¶ 37). From a legal analysis which merely finds that the states may require additional records, with even that finding limited to the subject matter of this proceeding ("in this instance"), the quoted language of Paragraph 8 leaps to a universal conclusion evidently opening the door to unidentified state

[2] 83 F.C.C.2d 267 (1980), *reconsideration*, 87 F.C.C.2d 916 (1981).

[3] 77 F.C.C.2d 384 (1980), *reconsideration*, 84 F.C.C.2d 50 (1980), *further reconsideration*, 88 F.C.C.2d 521 (1981), appeals pending in D.C. Circuit.

[4] Notice of Inquiry, FCC 81-576 released April 13, 1982.

[5] Communications Act of 1934, 47 U.S.C. § 151 *et seq.*

[6] ¶¶ 9-37.

departures beyond requiring additional records, and this without any discussion whatever of § 220(b).

Also included in the Order (¶¶ 33 and 34) are citations, with tacit approval, to state court or commission decisions rejecting FCC prescriptive power under § 220(b). It is astonishing to find in an Order of the FCC a reference, with apparent approval, to a California decision that the California commission "is not bound by the depreciation rates or methods set by the Federal Communications Commission. . . ." *See Pacific Tel. and Tel. Co. v. California*, 401 P.2d 353, 372-373, 58 P.U.R. 3d 229, 253-254 (1965).

Paragraph 37 of the Order sets out the governing principles recognized by the Commission and the courts in establishing the bounds of federal and state jurisdiction. It is there made clear that state actions, including state ratemaking, which imperil "important interests of national communications policy" will be preempted. But the language of the Order encompasses depreciation without any reference to the Commission's current depreciation policy, and implies Commission acceptance of state decisions rejecting FCC depreciation prescriptions without in any way considering the impact of such decisions of Commission policy objectives.

It is clear that there was no intent on the part of the Commission in adopting the Order to surrender any portion of its jurisdictional powers. The Commissioners were assured in open meeting that the Order would in no way undercut the Commission's ability to preempt inappropriate state action, and a favorable vote of the Commissioners proceeded only on these assurances. The unfortunate language of Paragraph 8, the apparent acceptance of state decisions rejecting FCC jurisdiction as "applicable state court precedents" (¶ 34), and various other elements of the Order discussed in this Petition, do not reflect either the Commission's intent or the intent of Congress as clearly expressed in the statute.

If not clarified, the Order will imperil Commission policies and objectives.

Without clarification, the Order will be read to signal a withdrawal of FCC decisional power, not only in terms of its Docket

20188 policies directed at timely capital recovery actually effected, but also as to implementation of CPE deregulation, where § 220(b) matters have been recognized time and again as an essential element in the Commission's program.[7] This is the worst time possible for a signal expressed in an FCC Order that it is uncertain of its own powers, just when the industry is embarking, under FCC mandate, on a complex transition from regulation to deregulation with billions of dollars in unrecovered CPE investment at stake.

The Order, without clarification, will create confusion and uncertainty even among state regulators disposed to accept FCC preemptive power. While the intent of the Commission was not to surrender its power, the language of the Order, and in fact the whole tenor of the Part II analysis, suggests otherwise. The result is that portions of the Order are being quoted out of context to support opposition to FCC prescriptions.[8] The effect of the Order at the state level is to provide ammunition for those who would argue that the California commission had the right idea all along in rejecting prescriptive FCC power in § 220(b).

A number of state commissions are proceeding to reject, in whole or in part, the FCC's depreciation policies and prescriptions. An example is recent action by the Public Utility Commission of Ohio. General Telephone Company of Ohio, one of the GTE telephone companies, is filing, concurrently with this petition, a petition seeking declaratory action. The Ohio company is faced with a clear conflict of federal and state depreciation decisions, with a differential between the two jurisdictions of more than $7 million in depreciation charges in the first year. Other jurisdictions have taken action, or are expected to take action

[7] *See*, for example, 84 F.C.C.2d at 68-69; and the Notice of Inquiry in CC Docket 81-893, ¶¶ 8-13 and 22.

[8] The Arkansas Public Service Commission has refused to give generic approval to remaining-life and ELG methods, preferring instead to "consider each company on its own merits." Order No. 3, Docket U-2989, May 7, 1982. The Arkansas PSC order was based on a staff recommendation that cited the FCC's Reconsideration Order in Docket 79-105 in support of state authority over depreciation of intrastate plant.

imminently, negating the effect of FCC prescriptions under § 220(b) as to depreciation methodologies and/or rates. Four United operating companies have been subject to state commission decisions on station connections expensing which vary from the commission's initial decision—with Nebraska denying permission to expense altogether.

The effect of this jurisdictional struggle will be to frustrate the FCC's policy directing timely recovery of invested capital, in the interests of ratepayers as well as carriers.[9] Moreover, as shown in the GTE Ohio company's petition, it will mean that the basic objective of depreciation, recovery of no more and no less than invested capital, cannot be realized. As we demonstrate in this Petition, Congress fashioned § 220(b) and related provisions precisely to prevent any such outcome.

DISCUSSION

The Order fails to recognize the critical distinction between § 220(a) and § 220(b).

The fundamental deficiency of the Order, as it deals with depreciation, is its failure to recognize the distinction between § 220(a) of the Act and § 220(b).[10] Congress carefully distinguished *discretionary* prescription under § 220(a) from *mandatory* FCC prescription under § 220(b), in the following language:

> Sec. 220(a) The Commission *may, in its discretion,* prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this Act, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys.

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[9] *See* 83 F.C.C. 2d at 275-277.

[10] The station connections expensing and amortization program of CC Docket 79-105 is at least as much a § 220(b) as a § 220(a) matter, since it essentially prescribes the depreciation expenses which will be allowed over a period of years.

> Section 220(b) The Commission *shall,* as soon as practicable, *prescribe* for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which *shall* be charged *with respect to each of such classes of property,* classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. *Such carriers shall not,* after the Commission has prescribed the classes of property for which depreciation charges may be included, charge to operating expenses any depreciation charges on classes of property *other than* those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation *other than* that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses. (Emphasis added)

With great clarity, Congress spelled out the FCC's:

> (i) *power* to prescribe ("The Commission may, in its discretion . . .") the full range of accounting requirements; and (ii) *responsibility* to prescribe ("The Commission shall, as soon as practicable . . .") both the classes of property for depreciation purposes, and the percentages of depreciation for each class.

With regard to § 220(b), Congress expressly prohibited carriers from departing from mandatory FCC prescriptions:

> Such carriers shall not, after the Commission has prescribed . . . charge . . . any depreciation charges . . . other than those prescribed by the Commission.

The Order fails to recognize that the Commission does not have to assume the onus of deciding the preemptive effect of its prescriptions of depreciation methodologies and rates. Congress

has determined that such prescriptions shall be conclusive by operation of law.[11]

In contrast, the FCC is explicitly provided with discretion as to accounting requirements under § 220(a). To reach the conclusion of Paragraph 37 of the Order as to any matter arising under § 220(a), that "federal regulation will not be frustrated if carriers maintain additional records for intrastate ratemaking purposes," no extensive legal analysis is required. The Commission is expressly given the discretion to make § 220(a) prescriptions non-preemptive, and it has done so in the past. *See* 68 F.C.C. 2d 902, 906-907 (1978), *reconsideration,* FCC 79-678 released November 6, 1979. But even under § 220(a), if the Commission decides to prescribe preemptively, § 220(g) makes clear the binding effect of any such action.

The legislative history of the Act, which is discussed in *Attachment 1* to this petition, reinforces the intent of Congress, clearly expressed in the statute itself, requiring the FCC to prescribe depreciation methodology and rates under § 220(b) and to assure compliance with its provisions prohibiting departures from such prescriptions. This Commission has explicitly recognized those obligations:

> This Commission is charged with the responsibility of approving depreciation rates for communications carriers subject to § 220(b) . . . . 87 F.C.C.2d at 923.

The Commission has recently interpreted 220(b) in docket 20188. Our next step is to consider the Commission's action in this important proceeding.

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[11] The FCC did not issue prescriptions under § 220(b) for the GTE telephone companies until 1976, evidently relying on the qualifying language of § 220(b), "as soon as practicable." Once prescriptions are issued, this qualification can have no application. The only provision of the Act in any other way qualifying the Commission's statutory obligation to prescribe, and to assure compliance with such prescription, is § 220(h), permitting exceptions for classes of carriers. No "classification of carrier" issue was raised in this proceeding, or would be relevant to prescriptions duly issued by the Commission.

The Commission's depreciation policies established in docket 20188, which recognized the impact on intrastate rates, must not be imperiled by state action.

The Commission's depreciation policies were articulated in Docket 20188 after many years of exhaustive study, by a decision reached on the unanimous vote of the Commissioners, and the Commission is continuing its very constructive effort to give practical effect to these policies.

In that proceeding, there was emphasis on the statutory base for Commission policy in § 220(a) and (b) of the Act. *See* 83 F.C.C. 2d a 272-273. Rules implementing § 220(b) were reviewed in detail, and new Rules adopted (at 273-275).

Most of all, the Commission focused on the substantive effect of depreciation. The Commission said "the purpose of depreciation is to make provision for recovery or charge of the original cost of the property by the end of its life" (at 275). With a number of citations to authorities, the Commission stressed the "principle of investor recovery of the whole cost of investment" (at 275-277). The authorities discussed made it clear that, in the event of inadequate provision for depreciation, the ratepayers bear the risk of loss (at 276-277). In view of these critical considerations of public policy, the Commission adopted a number of new approaches designed to protect ratepayers through timely capital recovery by telephone companies.

In approving remaining life and equal life group (ELG) methodologies (at 280-286 and 288-290), the Commssion recognized that it was carrying out the task assigned by § 220(b) of the Act. In so doing, the Commission rejected arguments of state commissions essentially based on the increases in rates which would follow FCC prescriptive action:

> We do not find increased rates [for subscribers] inconsistent, *per se,* with our mandate under Section 1 of the Act. . . . We must balance the interests of all present and all future customers in the preservation of adequate facilities at reasonable charges. On balance, we find it not unreasonable that present ratepayers incur some additional expense in order to preserve the integrity of the investment and to assure the

continued and longer term satisfaction of the requirements of our congressional mandate. *The only alternative, continued deferral of both recognition of current costs and initiation of corrective measures to rectify any past unrecovered costs, will require much larger adjustments to be made at some future date.* 83 F.C.C. 2d at 293, emphasis added.

In overriding the strenuous objections of state commissions expressed in docket 20188, the Commission, as stated in the language just quoted, *put aside the past practice* of "continued deferral" of cost recognition and corrective measures. In its place, the Commission adopted new depreciation policies discharging its statutory mandate to assure adequate facilities by maintaining the financial integrity of telephone companies and to protect consumers from the risk of having to bear the cost of depreciation shortfalls.

There can be no question that the Commission's decision gave careful consideration to the impact of new depreciation levels on interstate and intrastate ratepayers. In fact, the "excessive conservatism" of regulatory commissions in refusing to permit realistic depreciation levels because of the impact on rates was specifically noted by the Commission. *See Primer and Overview of Depreciation and Capital Accounting,* Prepared by the Chief, Accounting & Audits Division, August 8, 1980, page 26, issued by the Commission in support of its Report and Order. The Commission stressed that:

> [I]t is necessary that accounting and depreciation rules not stifle innovation and inhibit the introduction of new technology. . . . The seeming attraction of stretching out lives to hold down depreciation expenses may impose longer-term costs on our society that far outweigh the short-term advantages. Although our decision to permit SLELG [or remaining life] is likely to result in an increase in the near term in revenue requirements, we believe that the relative size of the increment will be repaid many times over in future years as the ability of regulated telephone companies to continue to provide '. . . rapid, efficient . . . communication service with adequate facilities at reasonable charges ['] is enhanced. 83 F.C.C. 2d at 281.

The Commission's decision in Docket 20188 was clear and emphatic, carrying out its congressional mandate while recognizing the need for consequent subscriber rate increases under both federal and state regulation.[12] The FCC adopted its depreciation policies by unanimous Commissioner vote after long and careful study, taking all relevant factors into consideration. These policies must be recognized at the outset as the kind of matter referred to in Paragraph 37 of the Order—"policies or rules we have adopted to carry out statutory objectives"; "federal policies or rules" with which state regulation must be reconcilable; and "important interests of national communications policy" which must not be imperiled by state action, including state ratemaking action.

The Order contains language concerning depreciation, not reflecting the Commission's intent, which is at odds with those principles set out in the order itself.

The analysis in Part II of the Order leads to the conclusion that "federal regulation will not be frustrated if carriers maintain additional records for intrastate ratemaking purposes" (¶ 37). While we would challenge the reading of statutory provisions and history at a number of points in the course of the Part II discussion, the essential conclusion just quoted is not an issue in this proceeding insofar as the Joint Petitioners are concerned.

No exhaustive review of legislative history is necessary to support the conclusion that states may require the generation of additional records for intrastate ratemaking purposes, if such action does not conflict with FCC policies. This point is established by the words of § 220(a) of the Act, which makes the FCC's prescription of accounting requirements a matter of FCC discretion. So long as the Commission does not exercise that discretion to prescribe accounting requirements on an exclusive and preemptive basis, clearly the states may continue their long-standing practice, in compliance with their own statutes, of

[12] The pleadings of various state commissions objecting to ELG and remaining life cited the consequent increases in intrastate rates as a reason for the FCC to reject these industry proposals. These filings would have been meaningless if the states did not recognize the power of the FCC to make these methodologies applicable for all purposes.

requiring the generation and production of additional records for purposes of their own regulatory functions, including ratemaking.

The point of serious concern in the Order, in terms of those "important interests of national communications policy" identified by the Commission in Docket 20188, is reflected in the following language of Paragraph 8 of the Decision:

> We have concluded, for reasons explained in Part II, that Section 220 does not preclude state commissions from departing from accounting or depreciation rules prescribed by this Commission for purposes of regulating intrastate telecommunication service rates.

The foregoing sentence can be read to open the door to action by state commissions far beyond merely requiring additional records. The quoted Paragraph 8 sentence (with related language in Paragraphs 3, 7 and 8), is being interpreted to allow *any* action of "state commissions . . . departing from accounting or depreciation rules prescribed by this Commission for purposes of regulating interstate telecommunication service rates."

The sweep of the quoted language of Paragraph 8 is far broader than the Commission could have intended. It embraces not only § 220(a) matters, where discretionary FCC powers are involved, but also § 220(b) matters, where the Commission operates under a statutory mandate to issue prescriptions. Such a broad sweep of language is unsupported by the discussion in Part II of the Order, which merely deals with the state power to require additional records. And it is in direct conflict with the language of Paragraph 37 of the Order, and the emphatic assurances given to the Commissioners in open meeting on April 1 that the Order would in no way undercut the Commission's ability to preempt inappropriate state action. It is clear that the Commission did not intend to strip itself of the power to give effect in the real world to those policies regarding depreciation, and related accounting issues, addressed in Docket 20188. But the Paragraph 8 language issues a confusing signal likely to be misinterpreted and to undermine FCC policies.

Paragraph 37 sets out the governing principles applicable to any exercise of federal preemptive power. State regulatory actions

that might interfere with, or tend to frustrate, policies or rules that the FCC has adopted to carry out statutory objectives with respect to interstate and foreign communications will be preempted. Where such circumstances arise, the FCC will override state agency actions, unless state regulation is reconcilable with federal policies and rules. Most importantly, state regulatory action, including state ratemaking action, will be foreclosed where those actions imperil "important interests of national communications policy". All of these sound principles are set out with ample supporting case law in the Order itself.[13]

The intention of the Commission, as expressed in Paragraph 37 and in numerous Commission pronouncements, is that critical national policy decisions of the FCC will not be negated by state action. It is clear that Commissioners and Staff at the April 1st meeting had this understanding of the matter. But as it emerged in the Order, most of all in Paragraph 8, and as it is being viewed at the state level, the impact of the Order is to undercut implementation of FCC depreciation policies.

The Ohio case requires FCC action clarifying the Order and applying the Commission's policies.

General Telephone Company of Ohio, one of the GTE telephone companies, is concurrently submitting to this Commission a Petition for Declaratory Ruling which will address the clear conflict between depreciation prescriptions issued, on the one hand, by this Commission,[14] and, on the other hand, by the Public Utility Commission of Ohio. As reflected in the GTE Ohio company's petition, there is a differential between federal and

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[13] The Order expresses each of these thoughts in double negatives rather than clear affirmatives. But there can be no challenge to the correctness of the formulation set out above, as recognized time and again by the Commission and the courts. Here, in fact, Congress' "statutory objective" in 1934 leaves the FCC with no choice but preemption. For a clearer and more definite statement of the FCC's preemptive power, *see* Brief for the FCC dated December 30, 1981, in the D.C. Circuit appeal of Docket 20828, page 68, et seq.

[14] *See* Order released January 28, 1982, FCC 82-40, and Order released February 3, 1982, FCC 82-53.

state prescriptions exceeding $7 million in depreciation charges for the first year of rate implementation. Not only does this mean that our Ohio company will not realize timely capital recovery, as the FCC intended in adopting its Docket 20188 policies and in issuing its prescriptive decisions under § 220(b) of the Act; it could mean that the Ohio company, caught between federal and state sovereigns, may be denied full recovery of invested capital. Either of these results would frustrate the Commission's policies adopted to implement its statutory mandate, and would violate the basic principles of equity and fairness which have governed federal/state regulation of carriers involved in providing both interstate and intrastate service.[15]

As a practical matter, the same piece of property cannot be depreciated successfully at two different rates. Under modern accounting methods, units of equipment are placed in groups. The costs represented by these groups are then allocated between interstate and intrastate jurisdictions. These allocations may change month to month, depending on measured jurisdictional use of the property in question. Given these circumstances, it is virtually inevitable that capital will be recovered more slowly or more quickly than one rate or the other calls for. If the intrastate ratepayer contributes too much, the interstate customer will give too little, and *vice versa.*

This impossibility of successful depreciation—that is, recovery of exactly the capital invested except by sheer coincidence—suggests that dual depreciation rates are not feasible and that a single rate should be used. If the commission believes that the rates it approves, based on carefully-developed federal policies and rules, should be the prevailing ones, it has the legal power to accomplish this.[16]

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[15] *See Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133 (1930).

[16] In the *North Carolina* cases cited in ¶ 37 of the Reconsideration Order, and in the *Computer II* decision of the FCC, 84 F.C.C.2d 50, 104, the essential indivisibility of the interstate and intrastate uses of telephone equipment was crucial to the legal outcome. Similarly here, despite the artificial attribution of property to intrastate and interstate jurisdictions, depreciation necessarily is a unitary process. The property cannot be divided successfully.

The Ohio case provides a specific example of direct federal/state conflict imperiling FCC policy objectives in the area of depreciation. The state commissions, when they strenuously opposed FCC action adopting ELG in Docket 20188, recognized the federal power. Now the Order is being interpreted to signal the withdrawal of federal power—and yet a close reading shows that this was not the Commission's intent at all. The Order must be reexamined and clarified to make certain that there is no misapprehension of the power and will of this Commission to make certain its depreciation policies are given real effect—which must mean capital recovery actually effected on a timely basis.

The Part II discussion will create serious problems in terms of future Commission action.

While the discussion in Part II of the Order leads merely to the conclusion that the states may require additional records, and even this conclusion is limited to the subject matter of this proceeding ("in this instance"), it contains many phrases and allusions that will create serious problems for the Commission in implementing its policies.

The Order says (¶ 34) that GTE is "asking us to repudiate nearly forty years of administrative practice;" but the Order does not recognize that the Commission has itself dramatically changed its practices and policies. For example, in the mid-1970s, the Commission concluded that the procedures previously applied to the GTE telephone companies, where "no objection" letters were issued, should be replaced by the issuance of formal FCC prescriptions under Section 220(b)—in order to bring FCC practice into closer conformity with the intent of Congress.

Docket 20188 also recognized the inadequacy of what had occurred in those previous years. As set out in the earlier discussion of Docket 20188, the Commission decided that there should *not* be "continued deferral" of cost recognition and corrective measures; rejected the "seeming attraction of stretching out lives to hold down depreciation expenses;" and emphasized that appropriate and timely increases in depreciation charges would be

"repaid many times over in future years."[17] Thus, it was the FCC itself that charted a clear new direction—but the Order never refers to Docket 20188 at all. Part II treats superseded practices respectfully, while ignoring the Commission's current policy, expressly designed to remedy the failings of those practices.

All of these elements, and more, of the Part II discussion will represent obstacles to Commission action in the future. In terms of Docket 20188 and depreciation prescriptions thereunder, this is already demonstrated by the Petition of General Telephone Company of Ohio. When the Commission decides to make certain that our Ohio company is able to effect capital recovery under FCC prescriptions, the unfortunate wording of the Order will be brought up to frustrate Commission action.

For example, if the matter reaches Federal Court, the Commission itself will be hard pressed to explain why the 1965 *P.T. & T.* case, discussed in Paragraph 33 with evident approval and apparently referred to in Paragraph 34 as "applicable state court precedents",[18] would not justify the conclusion that a state commission "is not bound by the depreciation rates or methods set by the Federal Communications Commission." *See* 401 P.2d at 372-373, 58 P.U.R. 3d at 253-254.

In terms of implementing the Commission's CPE deregulation program, the present Order, if not clarified, will represent a serious obstacle. A critical set of options which the Commission has under study[19] is action setting net book value as a proxy for economic value of CPE, or using other valuation methods, and dealing with any depreciation shortfalls or overrecoveries. With an FCC decision recently issued apparently endorsing California and Florida commission actions refusing to be bound by FCC prescriptions under § 220(b)—which is the way the Order is being interpreted—the result will be elimination, in practical terms, of

[17] *See* 83 F.C.C.2d at 281.

[18] No other state court decision is cited. A 1966 Florida Commission decision is referred to in Footnote 20 of the Order.

[19] *See* Notice of Inquiry in CC Docket 81-893, particularly Paragraphs 8-13 and 19-23.

FCC power to implement these options. This is another example of how the Part II descussion can be expected to obstruct FCC policies.

As to non-fully subject carriers, Part II of the Order is an obstacle to application of FCC preemptive power—also contemplated in CC Docket 81-893. If state commissions in California and Florida are not bound by FCC depreciation decisions as to fully subject carriers, as Part II of the Order implies, on what theory could it be maintained that non-fully subject carriers are bound?

By its terms, Section 220 applies to "carriers subject to this Act." If the Commissioner were to determine that the federal interest justified similar treatment for non-subject carriers, it would be well advised to base any required ancillary jurisdiction on the firmest possible statutory foundation.[20]

The Commission should reexamine Part II entirely,[21] to see whether, apart from its technical infirmities, it does not represent a serious block to implementation of the Commission's own policies.

We suggest certain clarifying language.

In order to dispel confusion and uncertainty as to FCC power and intent, we respectfully suggest the following specific changes in the Order:

1. CLARIFICATION OF PARAGRAPH 37.

The statement of principles set out in Paragraph 37 of the Order should be expressed in clear affirmatives rather than double negatives, and the relationship with the Commission's Docket 20188 policies should be clearly stated. This would be merely a

[20] The Supreme Court struck down FCC imposition of access requirements on cable systems, subject only to ancillary jurisdiction, when the FCC could not impose such requirements on broadcasters, subject to direct jurisdiction. *See FCC v. Midwest Video Corporation,* 440 U.S. 689 (1979).

[21] *Attachment 1* addresses certain serious misreadings of legislative history reflected in Part II.

question of recasting three sentenc s in Paragraph 37 to read something like the following:

- *State regulatory actions, including state ratemaking, that might interfere with or tend to frustrate the policies adopted by the FCC in Docket 20188 to carry out the statutory objectives set out in Section 220, Title II, and the entire Act, will be preempted.*
- *Where state regulation is not reconcilable with such policies, the FCC will override state agency actions.*
- *Congress intended this Commission to foreclose state regulatory action, including state ratemaking action, where any such action imperils the important interests of national communications policy established by the Commission in Docket 20188 in respect of depreciation and depreciation-related accounting matters.*

2. CLARIFCATION OF PARAGRAPH 8.

Paragraph 8 (with related language in Paragraphs 3 and 7) should be modified to make it clear that there is no intent, by virtue of the Order, to open the door to state commission action beyond simply requiring additional records. In other words, the scope of the language in Paragraph 8 should not be broader than the supporting discussion in Part II of the Order—and that leads only to allowing state commissions to require additional records. As an example, we suggest the following concluding sentence in Paragraph 8:

> *We have concluded, for reasons explained in Part II, that Section 220 does not preclude state requirements for the maintenance of additional records, so long as there is no conflict with any prescription of this Commission issued on an exclusive and preemptive basis.*

3. CLARIFICATION OF PART II.

Part II should be completely reexamined in light of FCC policy objectives. Most of all, Paragraphs 33 and 34 of the Order should be modified by explicit reference to the restated principles of Paragraph 37.

We suggest that these clarifications should accomplish the following Commission purposes.

Clarification of the Order, as suggested, should be designed to accomplish the following Commission purposes:

> *First,* explicit recognition that the Commission's decision not to preempt the states as to station connection expensing does not constitute abandonment of the Commission's "important interests of national communications policy" expressed in CC Docket 79-105 and Docket 20188, but was predicated on the understanding that these "important interests," as they relate to station connection expensing, would be substantially achieved in that case—under the descretion allowed by § 220(a)—without the necessity for preemptive action.

> *Second,* explicit recognition that the FCC's policies concerning depreciation, and depreciation-related matters, as set forth in Docket 20188, are matters coming within the phrases used in Paragraph 37 of the Order—as "policies or rules [the FCC has] adopted to carry out statutory objectives"; "federal policies or rules" with which state regulation must be reconciled; and a statement of "important interests of national communications policy" which must not be imperiled by state action, including "state ratemaking actions."

> *Third,* explicit recognition that FCC action under § 220(b) prescribing depreciation methodologies and rates is binding on carriers and state commissions.

CONCLUSION

We urge the Commission to clarify the Order, in the public interest, as set out in the preceding paragraphs.

Respectfully submitted,

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ATTACHMENT 1

In 1934, the House Report explicitly recognized that the NARUC-sponsored version of ¶ 220(j) represented a change from the Interstate Commerce Act.*

Part II of the Order errs in concluding that the 1934 Congress which adopted the new Communications Act "was completely silent as to its intent" in eliminating the House version of § 220(j) sponsored by NARUC; and that, at most, the silence could merely be construed to mean that the lawmakers "did not choose to resolve the question at that time." (¶¶ 27 and 29)

In fact, Congress was not silent. In the Report of the House Committee, which accepted the urging of the states that they not be limited in prescribing their own percentage depreciation rates for intrastate property, the pertinent amendments were said to be

> responsive to the requests of the State Commissions *that the present law be changed* so as to permit those bodies to exercise, for State purposes, certain jurisdiction over accounting systems and methods of depreciation accounting.[1] (Emphasis added.)

Thus, Congress understood that a change in the law was being recommended. By rejecting the House-proposed change sponsored by NARUC, as it did, the Conference on the 1934 legislation was deciding in favor of existing law.

The Interstate Commerce Commission and the courts had concluded that preemptive, prescriptive power over depreciation was granted by the Interstate Commerce Act.

Contrary to Part II of the Order, which purports to find only silence (¶¶ 17-20), both the Interstate Commerce Commission (ICC) and the courts were explicit in their views of the pertinent section of the Interstate Commerce Act (ICA).

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* See also pages 4-13 of the GTE Companies' Opposition to Petitions for Clarification and Reconsideration, June 11, 1981.

[1] H. Rep. No. 1850, 73d Congress, 2d Session, p. 7.

The antecedent of § 220(b) was § 20(5) of the ICA, as it stood after a 1920 amendment.[2] Section 20(5) was not amended between 1920 and 1934. Its wording was imported, with only inconsequential changes, into § 220 of the Communications Act of 1934. Thus, what the ICC and the courts said about federal depreciation authority during the period, 1920-34, when the ICC was assigned the chief responsibility for federal telephone regulation, is highly pertinent to the meaning of § 220.

In 1926 the ICC released its decision in *Depreciation Charges of Telephone Companies* (No. 14700), 118 I.C.C. 295 (1926), which concluded in part:

> "Telephone property, although used largely for local business, is subject to federal regulation when its is subject to interstate use." 118 I.C.C. at 296.

The ICC report embodying the decision went on to explain:

> It seems to be well established that where a local telephone company undertakes to originate or deliver toll messages, and most of them do so undertake, practically all of its property is open for use in interstate commerce and at any time may be so used. 118 I.C.C. at 332.

Thus, there could be no question of Congress' power to order uniformity in depreciation of interstate-use property. And, the report continued, the ICA evidenced Congressional intent to delegate such power to the ICC:

> Unless and until the provisions of paragraph (5) of Section 20 are changed by Congress, therefore, we feel that we must endeavor to enforce them in the case of such companies. 118 I.C.C. at 333.

"Such companies" referred to Class A, B and C companies for whom uniform accounting already had been prescribed, categorized according to annual operating revenues. Class D companies with revenues of less than $50,000 had been "exempted from our

[2] That provision, virtually unaltered, may now be found at 49 U.S.C. § 20(4).

accounting regulations, even though engaged to some extent in interstate commerce." 118 I.C.C. at 332

Accordingly, even for these smallest companies, the question was not one of ICC jurisdiction. Plainly, according to the 1926 decision, Congress intended, and the ICA conveyed, agency power over accounting and depreciation of all telephone companies. While the ICC, in its discretion, could allow the states to prescribe, it was clear that ***if the federal power were exercised,*** inconsistent state actions would be preempted. *See* 118 I.C.C. at 332.

In fact, the ICC chose to enlist the aid of the states, where possible, in accepting, reviewing and holding hearings upon telephone company depreciation proposals. The federal agency was very careful to use words indicating that the state commissions were simply helping, and were not supplanting federal jurisdiction. *See* 118 I.C.C. at 374-376. As it happened, the ICC never did issue a final order of direct federal prescription in the matter of telephone depreciation. Thus, in the absence of a federal *exercise* of depreciation-prescription power, the states were left free to act.[3] But the agency already had declared, in 1926, the power to preempt when it did prescribe, and no court rejected that view of the law.

Another indication of the view of the ICC of its powers under the ICA was contained in a letter of the then-Chairman of the ICC (referred to in the Order, footnote 15), which stated, with reference to the NARUC-sponsored version of § 220(j) ultimately rejected by Congress:

> Paragraph (j) . . . should be most carefully considered. It unquestionably directly conflicts with, and destroys the uniformity of systems of accounts and depreciation accounting required by the preceding provisions of the section. *That is not true under the present law.*[4]

[3] *Northwestern Bell Telephone Co. v. Nebraska State Ry. Commission*, 297 US 471 (1936).

[4] Letter printed in the March, 1934, Hearings, before the Committee on Interstate Commerce, 73d Congress, 2d Session, at page 208.

The intent of the 1934 Congress is clear; it must be carried out by the Commission.

As noted, when Congress acted in 1934, it recognized that the NARUC-sponsored version of § 220(j) represented a change from the depreciation-related provisions of the ICA. Not only is this reflected in ICC and court action; the Chairman of the ICC expressly made this point to Congress in questioning the appropriateness of NARUC's proposal, since it would directly conflict with, and destroy, uniformity of systems of accounts and depreciation accounting *"required by the preceding provisions of the section"* [*i.e.*, of § 220].

That Congress knew what it was doing in 1934 is clearly indicated in the words of the statute and its reports. This is demonstrated by the foregoing discussion, and further evidenced by looking at what Congress was doing with other regulatory statutes of same era. Congress knew how to provide for the states a reservation of jurisdictional power over depreciation. This was done in the Federal Power Act passed in 1935 and in the National Gas Act passed in 1938, where language similar to NARUC's § 220(j) was included.[5] Neither the 1934 Congress, nor any of the subsequent Congresses, chose to adopt the language which NARUC would have this Commission read into the Act.

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[5] *See* 16 U.S.C. § 825a(a) (August 26, 1935); and 15 U.S.C. § 717h(a) (June 21, 1938).